

ALASKA LEGISLATURE COMMITTEE FILES 1987-1988 8672

4942 HRES HB 149 - HB 164 (FILE 1) (see ELF)

BILL SHEFFIELD, GOVERNOR

**DEPARTMENT OF COMMERCE &  
ECONOMIC DEVELOPMENT**

POUCH D  
UNEAU, ALASKA 99811  
PHONE 465-2515

DIVISION OF INSURANCE

April 24, 1986

Honorable Mike Davis  
Alaska State House  
House Special Committee  
on Oil and Gas  
P.O. Box 7  
UnEAU, AK 99811-3100

Dear Representative Davis:

Re: HB 623. Oil pollution insurance availability  
for electric cooperatives

After receipt of Commissioner Bill Ross's letter of March 25, 1986, which clarified the types of damages covered under the financial responsibility requirements, we were in a position to identify potential markets and have shared that information with the Alaska Rural Electric Cooperative Association (ARECA). Additionally, we contacted several underwriters in an attempt to generate interest in ARECA.

We found several possible options which are, at the present time, being checked out by ARECA's insurance broker:

The International Surplus Lines Insurance Company is the only writer of monoline pollution liability insurance at a reasonable rate. It appears that the electric utilities have a good chance to obtain insurance through this outfit.

The Pollution Liability Insurance Association (PLIA) is a reciprocal pool that arranges reinsurance for its member companies covering pollution liability. Alaska Statutes 21.75.020 and 21.39.110 do not prohibit ARECA from joining such an arrangement. ARECA might wish to check out the requirements for becoming a member. Since ARECA is not a member of PLIA, PLIA will write pollution liability in connection with the general liability only if the whole risk has been submitted by a member company. For ARECA, that means that they might have to split the accounts where pollution liability is required.

Honorable Mike Davis

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April 24, 1986

Further, we found other insurance companies that would write under the conditions outlined by Commissioner Bill Ross of the Department of Environmental Conservation. However, they did not seem to be very cost efficient. We also made recommendations on how to limit the liability exposures and, consequently, obtain a better rate.

We will continue to touch base with the insurance companies and ARECA and try to improve communications.

If you want or need more discussion, I will be happy to expand on this letter.

Very truly yours,



Christian Ulinann  
Insurance Market Analyst  
Commercial Lines

CU/ss0242Z

042436a

cc: Representative Adelheid Herrmann  
Representative John Sund  
Commissioner Bill Ross, Department of Environmental Conservation  
Dave Hutchens, ARECA Insurance Exchange

# MEMORANDUM

RECEIVED AUG 28 1986  
State of Alaska

TO: Hal Brown  
Attorney General  
Department of Law

DATE: July 17, 1986

FILE NO:

TELEPHONE NO: 465-2600

FROM: Bill Ross  
Commissioner  
Department of Environmental  
Conservation

SUBJECT: Legal Opinion Re:  
Financial Responsibility  
Statutes AS 46.04.040

During the 1986 Legislature, legislation was introduced to exempt electric cooperatives from the Department of Environmental Conservation's oil pollution financial responsibility requirements. The filing of this bill was triggered by the difficulties that the cooperatives were experiencing in obtaining oil pollution insurance to meet the financial responsibility requirements of AS 46.04.040. This Department, the Division of Insurance, and the Department of Law worked closely with legislative staff and representatives from the electric coops to identify and resolve the insurance problems.

During hearings and discussions on this legislation, the electric cooperatives, raised concerns that the types of oil spill damages that they believed to be included under the financial responsibility regulations make it difficult to obtain insurance. Insurance representatives for the cooperatives indicated that insurance is not available for damages to the insured's own property or for penalties or damages of a punitive nature. The insurance industry maintains that insurance is only available for oil spill damages caused to third parties.

Consequently, during discussions of the bill, your office advised me that financial responsibility requirements did, in fact, extend only to third party liabilities. We were also informed that the Department's oil spill penalty and damage statutes are clearly not punitive but instead are used for compensatory and remedial purposes. I indicated my understanding of this advise in a March 25 letter to Representative Mike Davis.

As part of my effort to resolve this issue administratively, I agreed to request an Attorney General's opinion confirming the oral advise on the scope of damages that are compensable under our financial responsibility statutes. However, since the legislative session ended, we have found in our files a memorandum of advice dated May 13, 1982 that addressed most of the questions regarding financial responsibility that have been raised by the insurance representatives for the electric coops. Consequently, the only questions that remain to be answered concern the issue of third party liability coverage under the financial responsibility statutes. Specifically, I would appreciate your opinion on the following questions:

- What kind of oil spill liability (e.g. third or first party) is incurred by an oil operator demonstrating proof of financial responsibility under AS 46.04.040(i)? In other words, does the law require the operator to provide proof of financial responsibility to cover oil spill damages to the operator's own premises?

Hal Brown

-2-

July 17, 1986

Attached are copies of HB 628, my March 25, 1986 letter to Representative Davis, his response of April 2, 1986, and the 1982 memo of advice for your information. If your staff has any questions on this matter, Paul O'Brien, oil spill program manager, can provide additional information. Thank you for your assistance.

Attachments

cc: Doug Mertz

PO/bb



ALASKA

# NUSHAGAK ELECTRIC CO-OPERATIVE, INC

P. O. BOX 350 . DILLINGHAM, ALASKA 99576 . AREA CODE (907) 842-3251

January 23, 1987

Senator Fred Zharoff  
Representative Adelheid Herrmann

Thank you for giving us the opportunity to share some thoughts with you this date. Unfortunately I have a prior commitment and so will not be able to communicate with you in person but hopefully this short note will be better than nothing.

There are two major issues that are of concern to Nushagak Electric as well as to most of the rest of the rural utilities to some degree.

2. The second issue involves the financial responsibility insurance required for "terminal operators" as outlined in AS 46.04.040. This statute adversely impacts Naknek Electric, Nushagak Electric, the City of Nome and Kotzebue Electric because it requires that "terminal operators" I.E., those entities having over 10,000 barrels of fuel storage to purchase financial responsibility

insurance for the trans-shipment of fuel oil across the dock to the tank farm.

For Naknek Electric and Nushagak Electric, this process takes about 36 hours each and in 1986 we each had to buy insurance costing \$10,400 to comply with the statute. This cost each one of Nushagak Electric consumers about \$10.00 each.

This issue was raised in HB 628 which was sponsored by Herrmann and Adams last year. Unfortunately it did not go anywhere. However the problem is still with us. It seems to me that the statute was originally intended for oil terminals and shippers who may have been characterized as being of a more temporary nature. We, the utilities, are not temporary. We are a permanent part of the community and providing a necessary community service. In doing this, we have complied with all Federal and State regulations relevant to fuel handling. The U.S. Coast Guard oversees our fuel loading process. With all of the precautions taken, I find it difficult to reason why the State Statutes should require these rural communities to provide evidence of financial responsibility when they are least capable of doing so and when the U.S. Government does not require it.

Thank you again for your time and consideration of our concerns. I know I speak for all of the NEC Board of Directors and Membership of the Co-operative when I wish you a productive session this year in Juneau.

Yours very truly,

*[Handwritten signature]*

HB

164

(FILE 1)

(SEE ALSO ELF)

# MEMORANDUM

State of Alaska

WK → SC → NF

*red*

TO: Honorable Steve Comper  
Governor

DATE: June 25, 1987

FILE NO:

TELEPHONE NO:

THRU:

SUBJECT: State of the Economy

OFFICE OF  
MANAGEMENT & BUDGET

NOV 9 1987

STRATEGIC PLANNING

FROM: J. Anthony Smith, Commissioner  
Department of Commerce and  
Economic Development

## INTRODUCTION

Over the past several weeks, I have met with many executives who are close to the state of Alaska's economy. Their reports, off the record, are grim.

Dave Rose, Jim Sampson, Mark Hickey and I have discussed the short-range prospects for an economic upswing. Any near term economic projection bodes far worse than our public statements. While our diversification effort is promising over the longer run, we need to set in motion a short run program.

## Action Plan

With this in mind, there are several measures which can be undertaken immediately.

Overall, we recommend you consider the implementation of a short-term economic stabilization program. Following are some specific actions the State of Alaska can take. This is not at variance with your statements that you don't need an Income Tax or ELF to balance the budget because it is a specific program. The goal is to complete projects which are required for infrastructure needs in the diversification effort, but were overlooked in the politics of "monument" building.

The following criteria for projects should be considered:

1. That there is a return to the State in jobs and in creation of opportunities to diversify.

STRATEGIC PLANNING

NOV 23 1987

OFFICE OF  
MANAGEMENT & BUDGET

2. The selected projects cannot create O&M requirements.
3. Select smaller projects so that there is not an incentive for outside companies to come in.
4. The emphasis should be on private sector, Alaska companies. It may be necessary to waive bond requirements as appropriate.

#### IMPLEMENTATION -- Short Term

1. The Legislature suspends ELF. This would result in increased revenues of \$115 million for 1988 alone, according to figures from the Department of Revenue. These revenues are real capital that can be made available for projects that provide employment, create or improve infrastructure and allow the diversification program to be implemented. (For 1989 and 1990, increased revenues are estimated at \$125 million and \$135 million, respectively. These figures are based on the averages of projected oil prices.) The proposal is that the program would be such that the projects would linked to ELF.
2. We should canvass municipalities, boroughs, and State entities for status of all construction projects. For those projects already designed to specification and ready to build, we encourage notice to proceed be given to Alaskan architectural, engineering, and construction firms.
3. Through DOT/PF, set provisions in RFP's for state-wide projects to:
  - a) Utilize Alaskan design and engineering firms, local labor, local companies,
  - b) Select projects that are designed, permitted, and capable of being immediately let for bid;
  - c) Utilize local labor, local companies, local supplies and materials and be of local or statewide benefit; and
  - d) Select projects that can be administered by DOT/PF to insure that they facilitate economic diversification while we check the downward slide. However, force accounting should be avoided in construction projects.
4. Types of Projects Within the Scope of this proposal would include small Energy Projects, including small hydro-power such as was recently installed in Metlakatla and weatherization especially in rural locations. Other examples would be paving or road extension projects, and dock extensions/harbor improvements.

June 25, 1987

Mid-Term (one year out)

As you may be aware, Dave has proposed a Buy Alaska Campaign through Alaskan Permanent Fund dividend expenditures. If Alaskans spent their dividends in state, it is estimated there would be \$400 million invested in Alaskan goods and services.

In addition, the Department of Administration and DCED should aggressively promote Made In Alaska and Alaskan contracts and import substitution.

We should continue our aggressive pursuit of Trade Alaska, venture capital possibilities, implementation of the new AIDA, and other attempts at economic diversification. In this context, Dave Rose is talking to his asset manager about long term capital investment.

In conclusion, through these immediate steps to stabilize our economy, we can utilize the State's resources to create wealth within Alaska for its citizens. It is my opinion that at this time we cannot justify ELF for Prudhoe. Therefore, we should use linkage to allow us to redirect the economy while we prevent the recession from becoming a depression.

JAS02951  
102887a

STEVE COWPER  
GOVERNOR



STATE OF ALASKA  
OFFICE OF THE GOVERNOR  
JUNEAU

March 25, 1988

The Honorable Mitch Abood  
Chairman  
Committee on State Affairs  
Alaska State Senate  
P.O. Box V  
Juneau, AK 99811

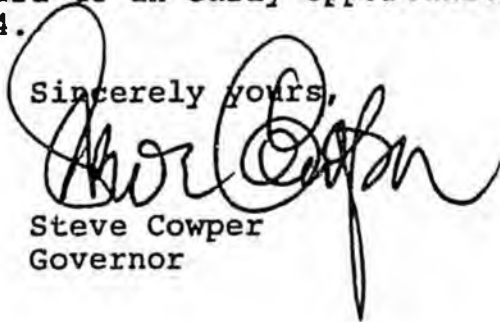
Dear Mr. Chairman:

On March 2, 1988, I wrote you requesting an early hearing on CSHB 164, the "ELF bill." In your reply of March 10, 1988, you recited the oil industry's arguments against the bill, and concluded by stating that "for these reasons CSHB 164 dated April 15, 1987, will remain in the Senate State Affairs Committee."

There seems to be some confusion here. My request was for a hearing. That request, which I reiterate, reflects a firm belief that senators should have an opportunity to hear both sides of an issue before passing judgment on whether a bill will "remain in the Senate State Affairs Committee."

My administration looks forward to an early opportunity to present testimony on CSHB 164.

Sincerely yours,



Steve Cowper  
Governor

# OIL WATCH

Division of Policy  
Office of the Governor

DATE: March 1, 1988

PREPARED BY: R.A. Fineberg

## Spot Prices

The ANS Gulf Coast spot price dropped to \$13.85-13.90 today. Over-supply and Saudi discounting again appear to be the principal factors in the latest price slump, which has driven the spot price down almost to its 12-month low (which occurred just before Christmas) and over \$2.00 below the price at the beginning of the year.

The Department of Revenue estimates current North Slope production at 2.03 million barrels per day.

Attached are updated graphs showing spot, contract and posted prices. Since the last time we provided these graphs (Oil Watch, January 14, 1988), ANS Gulf spot and posted prices have levelled out in the \$15 range. This makes \$15 a reasonable basis for projecting contract prices in the near-term -- at least prior to last week's drop.

## Effects on Mean Forecast for FY 88 and FY 89

A simplified model borrowed from the Department of Revenue indicates that if the ANS Gulf price holds at \$15.00 for the remainder of the fiscal year, FY 88 revenues should be approximately \$40 million below the \$2,095 million mean forecast of Feb. 11.

If \$15.00 held throughout FY 89, the February 11 mean forecast for FY 89 (\$1,981 million) would be approximately \$170 million high.<sup>1</sup>

## Delphi Forecast

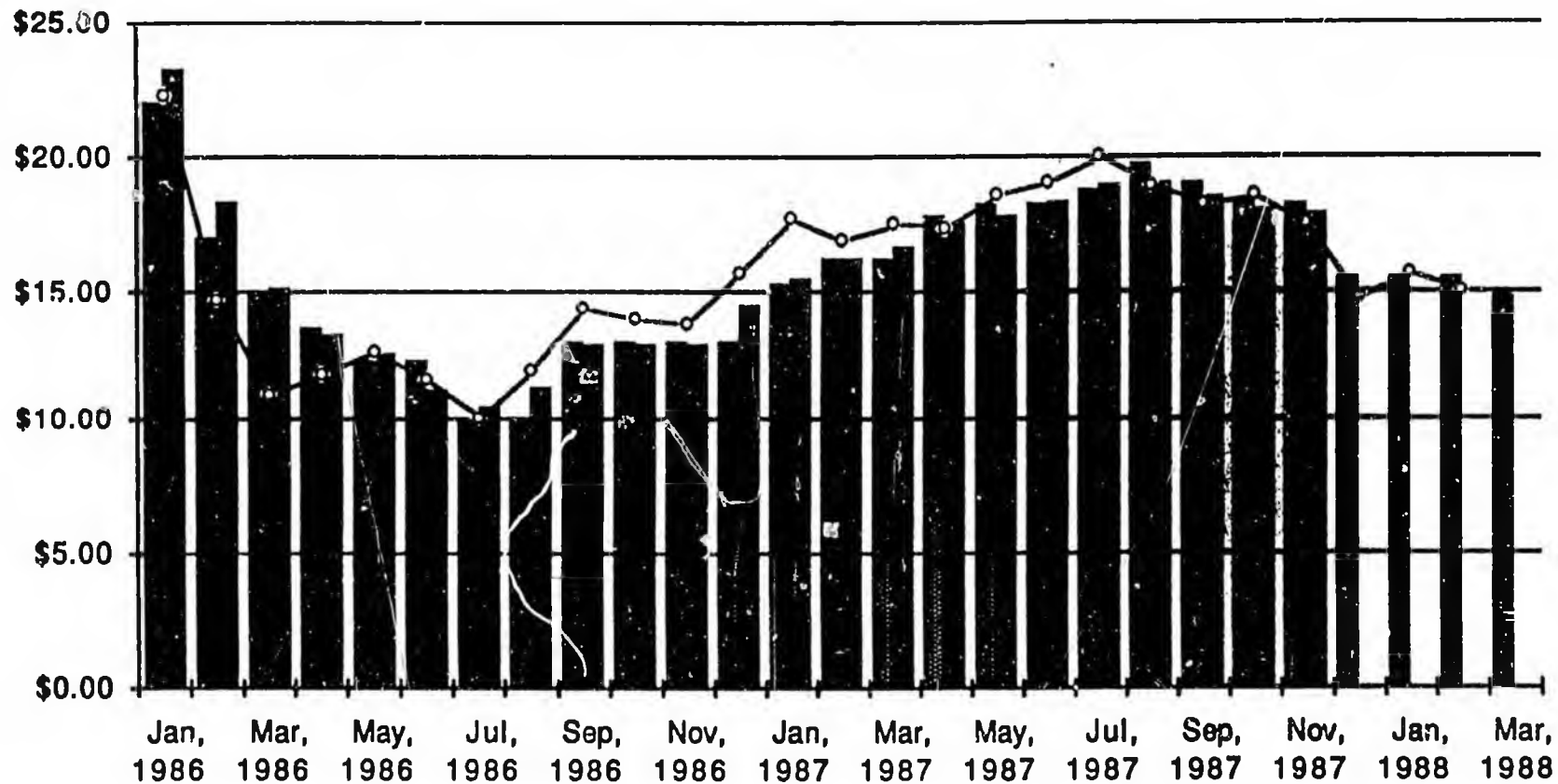
The forecast group will meet in Anchorage Monday and Tuesday, March 7-8. The completed forecast is expected early in April.

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<sup>1</sup> The simple rule of thumb is that a \$1.00 change in price over 12 months changes Unrestricted General Fund revenues by approximately \$130 million. The FY 89 mean forecast price for ANS at the Gulf is \$16.32.  $\$1.32 \times \$130 = \$172$  million.

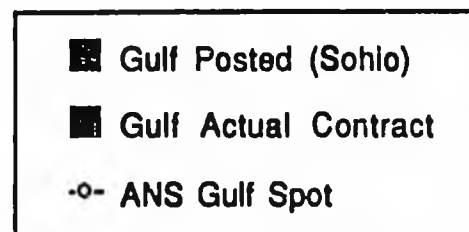
## ANS Gulf Actual v. Spot & Posted Prices (1986-88)

\$ / Barrel



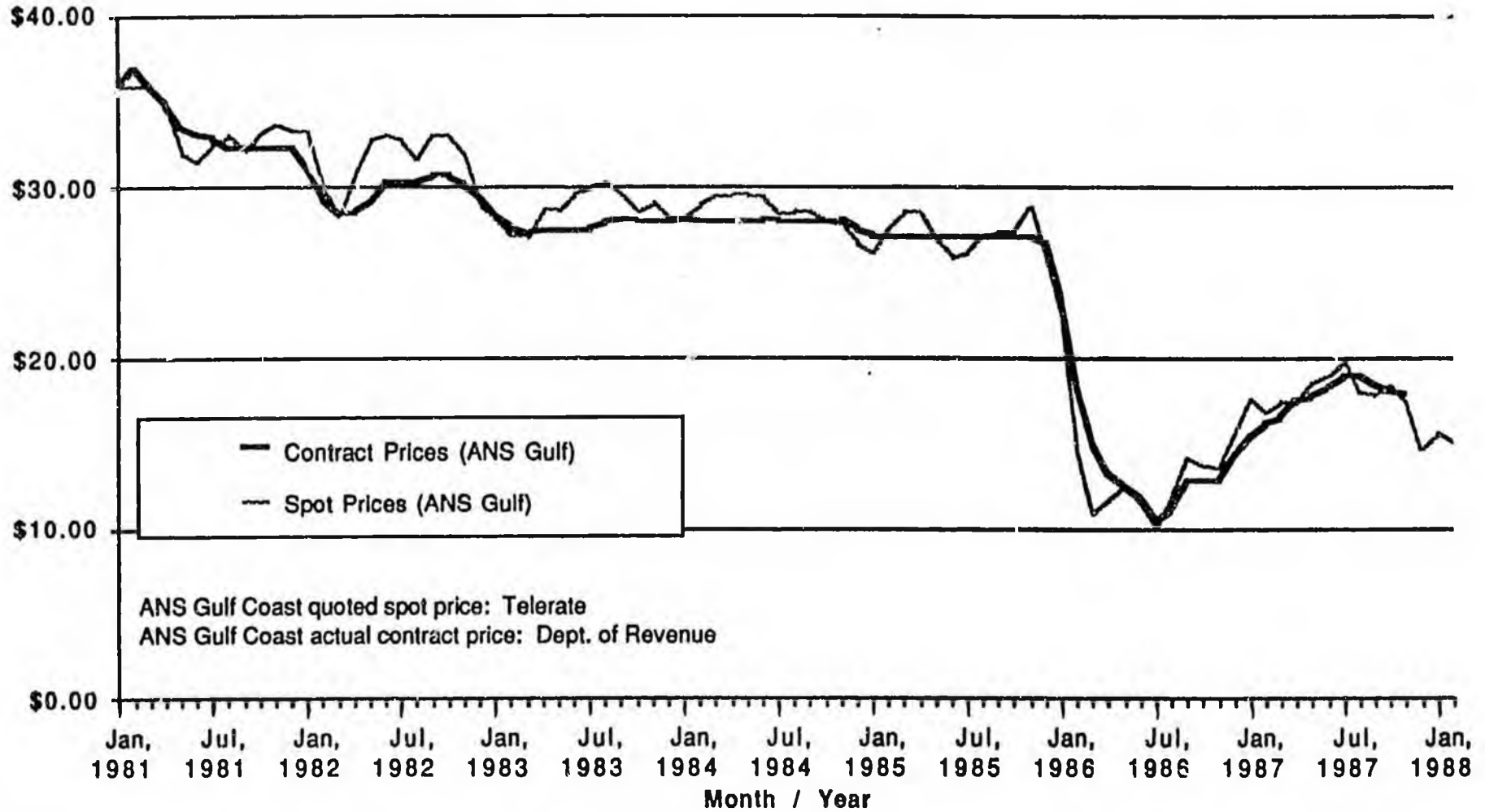
Source: Division of Policy

(from Standard posted price and DOR data; 3/1/88)



### ANS Gulf Spot and Contract Prices (1981-1988)

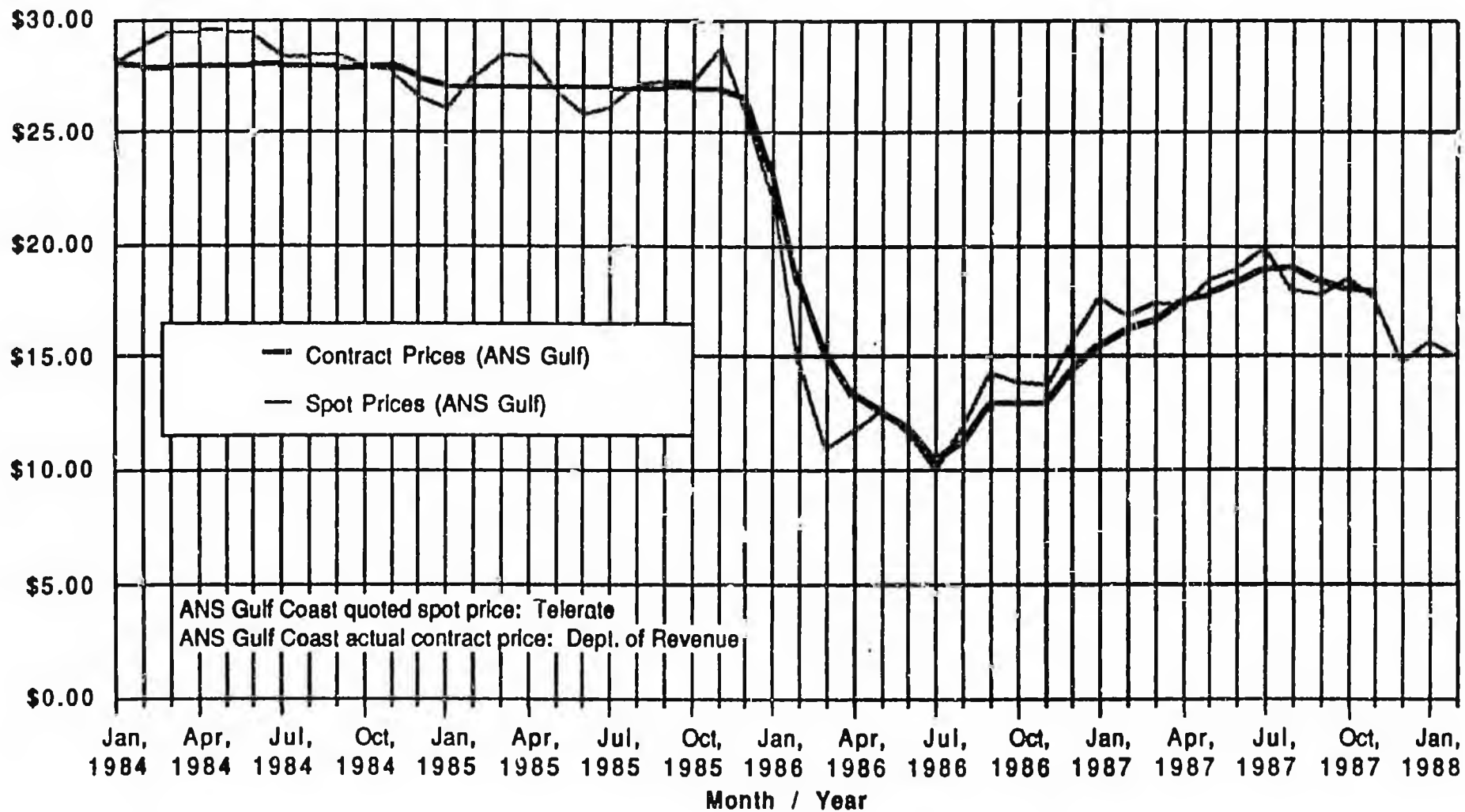
\$ / Barrel



Source: Division of Policy, 3/1/88

\$ / Barrel

### ANS Gulf Spot and Contract Prices (1984-1988)



Source: Division of Policy, 3/1/88

Distribution:

Governor Steve Cowper  
Garrey Peska, Chief of Staff  
Mary Halloran, Director, Division of Policy  
Jay Hogan, Director, Division of Budget Review  
Hugh Malone, Commissioner of Revenue  
Lennie Gorsuch, Deputy Commissioner of  
Natural Resources  
Cameron Kashani, Legislative Finance

# MEMORANDUM

State of Alaska

TO: The Honorable Steve Cowper  
Governor of Alaska

DATE: October 1, 1987

FILE NO:

TELEPHONE NO: 465-2173

THRU: Hugh Malone, Commissioner  
Department of Revenue

SUBJECT: September Forecast

FROM: Vincent D. Wright *vdw*  
Chief of Research  
Department of Revenue

The Department of Revenue has completed the September forecast and our assessment of the oil situation is basically the same as outlined in the June 5 memorandum to you on the subject. The numbers are somewhat higher, however, which is due to a combination of factors including (1) higher production assumptions stemming mainly from the Endicott field scheduled to come on stream shortly, (2) the fact that more revenue was generated than anticipated for the first quarter of FY 88, (3) adjustments in pipeline tariffs, (4) the Prudhoe Bay production decline curve being deferred until FY 90, and (5) the fact that this summer a premium price was paid for domestic crudes, including ANS, relative to OPEC crudes.

The market fundamentals suggest that oil prices will drop in the short-term given the excess supply of oil relative to the demand for oil, barring OPEC's ability to enforce its agreement of June 1987. The political abilities of OPEC to control market forces are, however, still very tenuous at this time.

## The Economics

1. The inventory situation is such that crude oil stocks are as high as they were a year ago and increasing at this particular point in time.
2. The self-assuredness on the part of OPEC some months ago that their agreements would succeed in controlling world oil markets has in fact led to violation of output quotas and overproduction. The end result has been increased volatility and sagging oil prices. The OPEC countries to be sure are attempting to rectify this situation via jawboning member countries but it remains to be seen whether or not they will be successful.

3. The projected economic growth of the U.S. and other countries is anticipated to be sluggish. The affect will serve to dampen demand for petroleum related products.
4. The competition from alternative energy sources is still intense and will likely act to put a ceiling on any upward movement of oil prices in the future.
5. The refining industry in the U.S. and elsewhere is experiencing a squeeze on profit margins. The action of raising final product prices is limited by its negative effect on demand.

The conclusion we reached in June was that the "potential for oil prices faltering if not dropping is tremendous" and this indeed has already occurred.

#### The Politics

1. The incentives for the thirteen member OPEC group to hold together their agreement of June 1987 and even adjust it if necessary to insure success are fairly clear-cut. Most members are experiencing a negative cash flow situation and some are deeply indebted to other countries and the world banking system. Coupled with this is the fact that since 1982, with the drop in the price of oil, economic stagnation has plagued most of these countries. The political pressures from within these countries to rectify the situation are tremendous. But OPEC's struggle to succeed in holding together their June accord is fraught by divergent economic, religious, political, and financial interests.
2. In June we noted that Saudi Arabia had once again adopted the role of swing producer (i.e. agreed to adjust output below their allotted quota to make the OPEC agreement viable) but stated that this action would be temporary in light of their monetary situation. Since that time Saudi Arabia has announced it will no longer serve as swing producer for OPEC. The significance of this policy, if in fact it is adhered to, means that if other OPEC members violate their quotas, then there will be no one there to bail them out as has been the case in the past. Saudi Arabia, via this announcement, is attempting to push the other members into shouldering their responsibilities. In view of the history of OPEC member actions, this may be a futile effort on

the part of Saudi Arabia. The problem is that Saudi Arabia cannot afford, because of dwindling assets, to serve as swing producer indefinitely.

3. The Iran/Iraq war is a thorn in the side of all concerned. The Iraqis absolutely refuse to go along with their allotted output quota. Moreover, new pipelines in the process of being built are expected to provide additional Iraqi export capability. In view of the war effort and their indebtedness to the Saudi and Kuwait governments, Iraq has no choice but to go all out. It is literally a matter of survival.

On the other hand if Iraq and Iran settle their war, production from these two countries could increase even more dramatically in an effort to rebuild their shattered economies.

4. I noted in the last forecast that "one of the major problems confronting OPEC, which Saudi Arabia and others recognize is the confidence on the part of some that the problem has been resolved and that OPEC is once again in control. Hence, some members are demanding that a higher official price be established. Others such as the UAE are demanding that their respective quotas be increased and if not, they will increase production regardless."

Some of these countries did attempt to raise prices and have increased output and we have seen the results over the last forty-five days. OPEC is having a great deal of difficulty in keeping the situation under control. The responsible members of OPEC are cognizant of the fact that the current agreement is in jeopardy, and so what we see lately is a special OPEC committee designated to visit each member country with the idea of impressing upon them the necessity to refrain from violating the current accord.

Off to the sidelines are the non-OPEC countries confronted by their own economic, political, and financial problems, closely watching and doubting OPEC's resolve. Many of these countries refuse to make further concessions to support the OPEC accord. Some have gone much further, to the chagrin of OPEC, and publicly announced they will go their own way if OPEC cannot adhere to its agreement. The end result, of course, would be to undermine any semblance of an OPEC accord.

#### The Conclusions

What does the above thumbnail sketch boil down to? It is quite obvious that there are few if any economic fundamentals suggesting that prices will increase and many reasons why they might decrease. The situation is one where OPEC actions, via delicate political maneuvering to control supply and demand, serve to bolster prices. And this is an area where the cohesiveness of OPEC, as alluded to above, is beset by problems.

The Honorable Steve Cowper  
October 1, 1987  
Page 4

What does this portend relative to oil prices? Will they increase? If OPEC can restrain individual members from engaging in widespread violations of the current agreement, if non-OPEC countries reaffirm their support, if worldwide demand for petroleum products remains positive, and if inventories are reduced, then prices should steady and perhaps increase next spring. The odds are increasing, however, that prices will drop further this winter as we indicated in June. The primary reason why prices have been holding lately is because of tensions in the Mid-East. The Achilles' heel to this, if there is one, is the fact that OPEC is taking advantage of this situation by pumping excessive quantities of oil, and at some point this action is surely going to have an adverse affect on prices. This means that prudence dictates a cautious approach relative to the State's spending plans.

The unrestricted revenue numbers are \$1,728.2 million, \$1,934.0 million, \$1,784.6 million, and \$1,925.4 million for FY 87, FY 88, FY 89, and FY 90 respectively. The changes, when compared to the June forecast, represent increases of \$54.1 million, \$217.9 million, and \$112.5 million for FY 87, FY 88 and FY 89 respectively. The figure for FY 90 represents the introduction of a new year as is traditional during this time of the forecasting cycle.

The FY 87 number must be adjusted upward by \$70.6 million for TAPs legal expenses and refunds. When this adjustment is made, the bottom line for FY 87 then amounts to \$1,798.8 million. This compares to a bottom line figure in June of \$1,741.3 million.

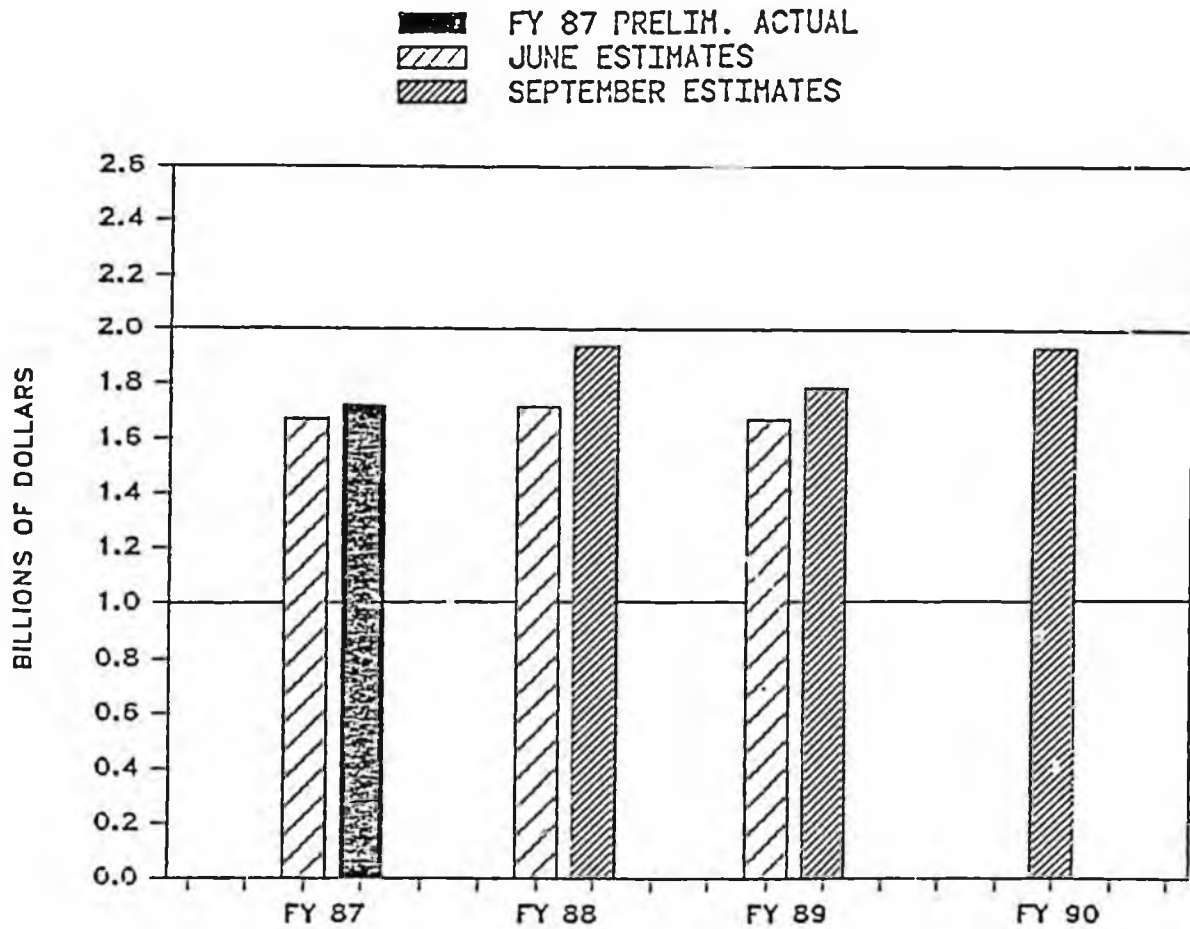
Please note that the FY 87 number represents the preliminary actuals whereas the projected figures for FY 88, FY 89, and FY 90 represent the conservative 30% case.

I have attached for your perusal the details of this forecast along with the basic underlying assumptions, a short history of the State's revenue picture, and charts indicating the nominal versus real dollar outlook.

VDW:mkw

Attachment

FIGURE 1  
**GENERAL FUND UNRESTRICTED REVENUES**  
 (COMPARISON OF PRIOR FORECASTS)



FY 87 Estimate/Prelim. Actual

June 1987	1.6741 billion
September 1987	1.7282 billion

FY 88 Estimates

June 1987	1.7161 billion
September 1987	1.9340 billion

FY 89 Estimates

June 1987	1.6721 billion
September 1987	1.7846 billion

FY 90 Estimate

September 1987	1.9254 billion
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\* IT SHOULD BE NOTED THAT ALL "SPECIAL SETTLEMENTS" HAVE BEEN EXCLUDED IN FY 87 IN ORDER TO BE CONSISTENT IN COMPARING PRIOR FORECASTS. THE FY 87 BOTTOM LINE WOULD INCLUDE AN ADDITIONAL \$69.1 MILLION (TAPS REFUNDS/LEGAL EXPENSES) AND \$1.5 MILLION (ARCO COURT COSTS).

TABLE I  
General Fund Unrestricted Revenues  
(Thousands of Current Dollars)

<u>Taxes</u>	FY 1987 Prelim. Actuals	FY 1988 Estimate September	FY 1989 Estimate September	FY 1990 Estimate September
<u>Income</u>				
Corporate-General	20,500	16,000	16,000	16,000
Corporate-Petroleum	120,400	120,000	120,000	120,000
<u>Gross Receipts</u>				
Alaska Business License	1,500	1,500	1,500	1,500
Fish-Canned/Shorebased (1)	17,500	6,000	7,000	9,000
Fish-Floating	9,000	9,800	9,800	9,800
Seafood Marketing	1,400	1,600	1,600	1,600
Salmon Enhancement	4,400	4,900	4,900	4,900
Insurance Companies	23,700	23,600	23,000	23,000
Electric & Telephone Co-ops	2,000	1,900	1,900	1,900
Mining License Tax	300	400	400	400
<u>Severance</u>				
Oil & Gas Production (2)	639,500	728,600	658,700	753,000
Oil & Gas Conservation (3)	1,200	2,500	2,500	2,600
<u>Property</u>				
Oil & Gas	102,500	75,000	67,000	60,000
<u>Sale/Use</u>				
Alcoholic Beverages	12,600	12,300	12,000	11,900
Fuel Taxes-Aviation (4)	8,500	8,300	8,200	8,200
Fuel Taxes-Highway (4)	18,300	19,000	18,700	18,700
Fuel Taxes-Marine (4)	5,400	5,000	5,000	5,000
Tobacco Products	6,600	6,300	6,100	6,000
<u>Other</u>				
Estate	1,100	700	700	700
Total Taxes	<u>996,400</u>	<u>1,043,400</u>	<u>965,000</u>	<u>1,054,200</u>
 <u>Licenses &amp; Permits</u>				
Business (5)	8,600	8,500	8,500	8,800
Non-Business	19,200	19,000	19,000	19,500
Total Licenses & Permits	<u>27,800</u>	<u>27,500</u>	<u>27,500</u>	<u>28,300</u>
 <u>Intergovernmental Receipts</u>				
Federal Shared Revenues (6) (7)	<u>11,700</u>	<u>9,500</u>	<u>9,800</u>	<u>10,000</u>
 <u>State Resource Revenue</u>				
<u>Sale/Use</u>				
Bonus Sales (6) (8) (9)	500	3,300	-0-	-0-
Investment Earnings (10)	161,900	115,000	90,000	60,000
Rents (6) (8) (9)	5,800	6,000	6,500	6,500
Royalties (2) (6)	445,100	654,700	608,800	688,200
Sale of State Property	7,000	7,500	7,500	7,500
Gravel, Timber, etc. (11)	7,200	2,500	2,500	2,500
<u>Facilities Related Charges</u>				
Airports	1,500	1,600	1,600	1,600
Ferry System-Southeast	27,500	29,000	31,000	32,000
Ferry System-Southwest	3,800	3,500	4,000	4,100
Other	4,000	5,000	5,000	5,000

### Service Related Charges

Court System	5,300	5,400	5,600	5,700
Other	4,700	4,700	4,800	4,800
<b>Total State Resources</b>				
Revenues	674,300	838,600	767,300	817,900
Miscellaneous Revenues	18,000	15,000	15,000	15,000
<b>Unrestricted Revenues</b>	<b>1,728,200</b>	<b>1,934,000</b>	<b>1,784,600</b>	<b>1,925,400</b>
Plus: Special Settlements (12)	70,600	-0-	-0-	-0-
<b>Total Unrestricted Revenues (13)</b>	<b>1,798,800</b>	<b>1,934,000</b>	<b>1,784,600</b>	<b>1,925,400</b>

(1) The FY 88, FY 89, and FY 90 figures reflect the recent enactment of a shorebased fisheries business tax credit which is limited to 50 percent of the business' total tax liability with any unused portion of the credit carried forward two years (Ch. 79, SLA 1986, effective July 1, 1986). For example, the total FY 88 fisheries business tax liability is estimated at \$30.0 million against which \$14.2 million of estimated credits are applied thus yielding a total net fisheries business tax of \$15.8 million. This state share will then be further reduced by municipal revenue sharing. The current fisheries business tax has been combined into a single category with the shorebased since the tax credits are applied against the aggregate return and cannot be allocated by specific processing type.

(2) The forecasted numbers for FY 88, FY 89, and FY 90 assume the 30 percent case; however, if the mean case had been utilized for FY 88, FY 89, and FY 90, the production taxes would change to \$758.9 million, \$764.9 million, and \$857.1 million, respectively. The royalty figures would change to \$715.7 million, \$768.6 million, and \$786.4 million, respectively. All of the forecasted numbers include the estimated TAPS settlement.

(3) Ch. 56, SLA 1987 increased the levy from 1.25 mills to 4.00 mills per barrel of oil and per 50,000 cubic feet of natural gas, effective June 13, 1987.

(4) In FY 86 and FY 87 the Department of Revenue began to levy marine fuel taxes on watercraft motor fuel users who purchased fuel out-of-state but consumed fuel in transit through the state. On March 30, 1987, the State adopted hearing decision #87-07 which established that marine fuel users who merely consumed fuel in transit could not be retroactively taxed. In line with this decision, the Department of Revenue has refunded with interest any taxes collected under the earlier interpretation. This forecast estimates that refunds plus interest will total \$1.8 million and assumes that the majority of these refunds paid in FY 87. All motor fuel tax refunds are paid from the Highway Fuel Tax Account.

(5) Figures reflect the recent shift in occupational licensing fees and insurance permit fees from General Fund Unrestricted Revenues to Restricted Program Receipts.

(6) Net Permanent Fund contribution by Ch. 18 SLA 1980.

(7) The FY 87 figure reflects the CCS "8(g)" revenue-sharing settlement of \$4.0 million. The General Fund share represents 49.5 percent of the aforementioned total, whereas the Permanent Fund will receive 50.0 percent. The remaining 0.5 percent will be distributed to the Public School Fund.

(8) Reflects state lease sales of \$0.9 million held June 24, 1986 (Sale 49 - Cook Inlet), \$0.3 million held January 27, 1987 (Sale 51 - Prudhoe Bay Uplands), and \$6.6 million held June 30, 1987 (Sale 50 - Camden Bay). Due to the timing of collections, receipts from the June 1986 lease sale are shown as FY 87 revenue, and receipts from the June 1987 lease sale are shown as FY 88 revenue. The bonus figures represent the General Fund's 49.5 percent share.

(9) The Department of Natural Resources projects the following FY 88, FY 89, and FY 90 state lease sales: FY 88 (Sale 54 - Kuparuk Upland, Sale 55 - Demarcation Point, Sale 66A - North Slope Exempt); FY 89 (Sale 52 - Beaufort Sea, Sale 56 - Alaska Peninsula, Sale 67A - Cook Inlet Exempt); and FY 90 (Sale 59 - Cook Inlet, Sale 57 - North Slope Foothills). However, bonus bids are impossible to anticipate prior to sales; therefore, no estimates are provided.

(10) The investment earnings projections reflect the current composition of General Fund assets and current interest rates. The projections reflect a liquidation of General Fund assets over the period because projected General Fund cash expenditure outflows exceed projected General Fund cash revenue inflows. Cash inflows are consistent with the current revenue forecast. Cash outflows are consistent with the current FY 86 budget. General Fund operating expenditures were assumed to remain at approximately FY 88 levels through FY 90.

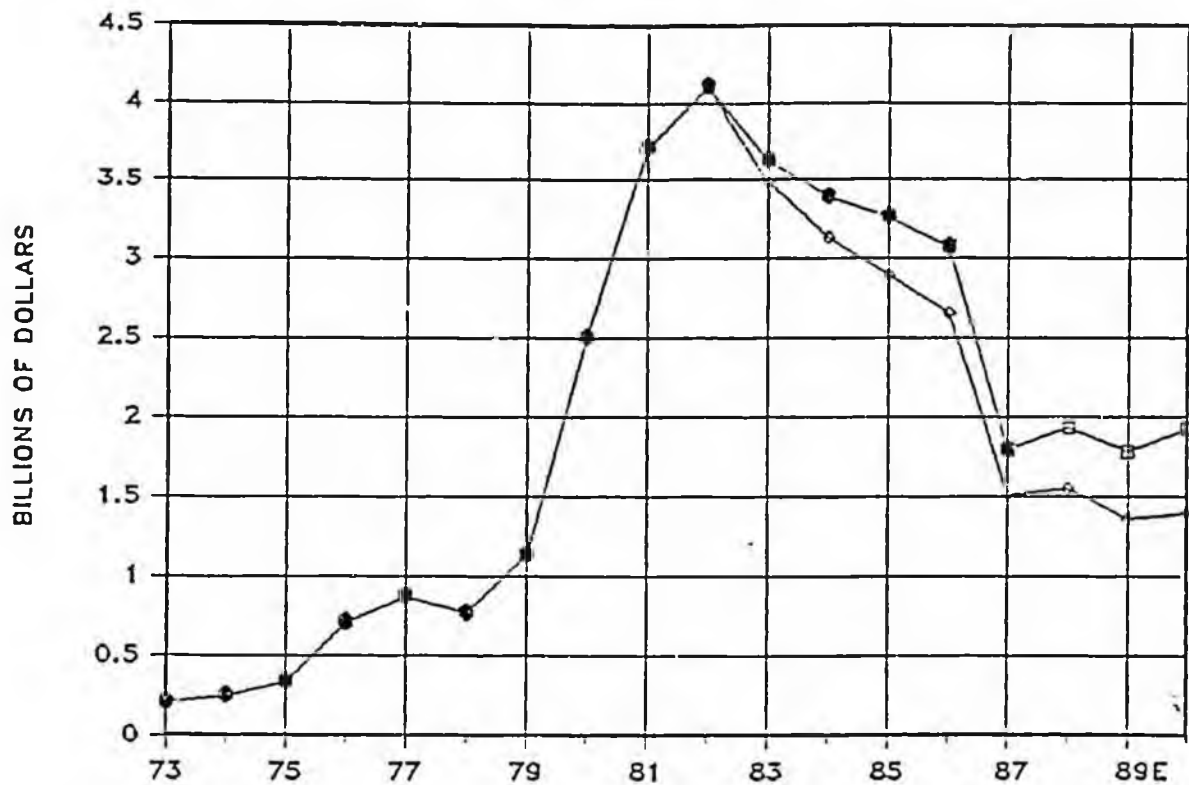
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(12) The FY 87 figure reflects the General Fund portion from refunds and expenses for prior years relative to the TAPS case (\$65.1 million) and court costs relative to the ARCO settlement (\$1.5 million). Consequently, \$70.6 million was received during FY 87, but this figure is subject to future audits.

(13) The State, per AS 38.05.160, will be granting incentive credits against royalties, severance taxes, and rentals to the oil companies for drilling exploratory wells. The deduction is approximately \$2.9 million which has not been subtracted from the aforementioned FY 87 figure of \$1,798.8 million. Additional credits are anticipated in subsequent years.

FIGURE 2  
GENERAL FUND UNRESTRICTED REVENUES  
(NOMINAL DOLLARS VS. REAL DOLLARS)

- ACTUALS(NOM\$)
- ESTIMATES(NOM\$)
- ◊ ACT/EST(REAL\$/1982)



Revenue Actuals  
(Nominal \$)

FY 73	.2082 billion
FY 74	.2549 billion
FY 75	.3334 billion
FY 76	.7098 billion
FY 77	.8743 billion
FY 78	.7649 billion
FY 79	1.1330 billion
FY 80	2.5012 billion
FY 81	3.7182 billion
FY 82	4.1084 billion
FY 83	3.6310 billion
FY 84	3.3901 billion
FY 85	3.2600 billion
FY 86	3.0755 billion
FY 87*	1.7988 billion

Revenue Estimates  
(Nominal \$)

FY 88	1.9340 billion
FY 89	1.7846 billion
FY 90	1.9254 billion

Revenue Actuals/Estimates  
(Real \$/1982)

FY 82	4.1084 billion
FY 83	3.4826 billion
FY 84	3.1347 billion
FY 85	2.9002 billion
FY 86	2.6584 billion
FY 87	1.5096 billion
FY 88	1.5560 billion
FY 89	1.3681 billion
FY 90	1.4019 billion

\* Preliminary

TABLE II

Key Assumptions for September 1987  
 Petroleum Revenue Projections  
 For FY 1987 - FY 1990

<u>Fiscal Year</u>	<u>(\$/bbl) Mean Wellhead Value</u>	<u>(\$/bbl) 30% Wellhead Value</u>	<u>Mean TAPS Throughput (MMbbs/day)</u>	<u>Mean Rate Inflation %</u>
1987	\$7.35	\$7.35	1.858	3.02
1988	\$11.11	\$10.17	1.903	4.32
1989	\$10.74	\$9.25	1.949	4.92
1990	\$12.05	\$10.57	1.929	5.45

Sales Price for  
Alaska North Slope Crude Oil at Los Angeles, California

	<u>Weighted Average</u>	<u>30% Case</u>	
FY 87	\$13.42	\$13.42	per barrel
FY 88	\$15.98	\$15.04	per barrel
FY 89	\$15.16	\$13.67	per barrel
FY 90	\$15.90	\$14.42	per barrel

Sales Price for  
Alaska North Slope Crude Oil at Houston, Texas

	<u>Weighted Average</u>	<u>30% Case</u>	
FY 87	\$14.70	\$14.70	per barrel
FY 88	\$17.16	\$16.22	per barrel
FY 89	\$16.32	\$14.83	per barrel
FY 90	\$17.08	\$15.60	per barrel

Weighted Average TAPS Tariff

FY 87	\$4.25	per barrel
FY 88	\$3.52	per barrel
FY 89	\$2.69	per barrel
FY 90	\$2.66	per barrel

# MEMORANDUM

# State of Alaska

TO: The Honorable Steve Cowper  
Governor of Alaska

DATE: June 5, 1987

FILE NO.:

THRU: Hugh Malone, Commissioner  
Department of Revenue

TELEPHONE NO.: 465-2173

SUBJECT: June Revenue Forecast

FROM: Vincent D. Wright *VW*  
Chief of Research  
Department of Revenue

The Department of Revenue, per your instructions, has put together the unrestricted revenue forecast approximately one month earlier than is normally the case. You should be aware that by moving up the schedule we have not had the benefit of evaluating key information such as economic and tax data normally available, seasonal factor trends, nor the results from the OPEC meeting scheduled for the latter part of June.

There has been a great deal of speculation recently that oil prices will continue to improve and the State's revenue position in corresponding fashion. This may very well be true. However, there are factors that still suggest tremendous downside risk relative to oil prices and I will touch on some of these in this letter.

The fundamentals of supply and demand do not support current oil prices. The underlying reason for relatively high oil prices is a political solution (i.e. the OPEC agreement established during December of 1986) which is still very tenuous at this time. The reasons for this are outlined below and it is crucial that the decision makers recognize these facts and adjust their thinking relative to expected revenues accordingly.

## The Economics

1. Oil prices are relatively high because OPEC has restricted production and partly because refiners worldwide have been purchasing oil in vast quantities in anticipation of still higher prices. So what we have are very large inventories on hand. Unleaded gasoline stocks in this country alone are 30% higher than a year ago. Crude stocks in the U.S. are fairly close to their levels of last year and worldwide they are considerably higher than a year ago.
2. The value of the dollar has declined in the last 24 months relative to Japanese and some European currencies. Since OPEC oil is pegged in terms of the dollar, it has been relatively cheap and so this too has served as a stimulant to overseas refiners to purchase and thus build large stocks of crude.

The Honorable Steve Cowper  
June 5, 1987  
Page 2

3. The increasing self-assuredness on the part of OPEC that their December 1986 agreement has succeeded in controlling world oil markets is now leading to overproduction. Their second quarter quota is 15.8 million barrels per day but they are now producing between 16.5 to 17 million barrels per day. Saudi Arabia is becoming worried about the increasing tendency on the part of some OPEC members to step-up their cheating.
4. Higher levels of inflation are occurring. Last year the Consumer Price Index (CPI) was 1.9%. Now inflation is running between three and four percent and is projected by many to continue to climb. Higher inflation means higher interest rates which in turn means higher costs in storing oil. At some point this could lead to a divestiture of oil inventories. Hence, dumping of crude on world markets could occur.
5. The projected economic growth of the U.S. and other countries is sluggish at best. Worldwide GDP growth for non-communist countries is expected to run 2.5% next year. Thus, the demand for petroleum related products will be affected.
6. Alternative energy sources such as natural gas, of which large reserves exist around the world to operate utility and industrial plants, are currently on a btu parity value with various crudes. During those earlier years (the late 70's and early 80's) of relatively high oil prices, many existing utility and industrial users retrofitted to handle alternative fuels like natural gas. Further, newer plants built during the last few years have concentrated on diversifying so as to be able to burn alternative sources of energy should oil prices once again soar. The point is that competition from substitute fuels is more intense than ever and will likely act to restrain the upward movement of oil prices in the future.
7. Historically, demand for oil in this country has dropped and for the last several years to the tune of approximately 1 million barrels per day during the summer months. This same phenomena occurs throughout the rest of the world as well. The primary reason for this is destocking due to less heating oil usage. Since this has happened almost every year for over a quarter of a century, there is no reason to anticipate that the situation will change. The drop in demand for oil due to seasonal factors is just around the corner.
8. Refiners in the U.S. and elsewhere are now experiencing a squeeze on refinery or profit margins i.e. crude costs are going up relative to the price of the finished product. Refiners would like to raise product prices to cover their costs. But over time higher prices will act as a damper on demand.

In conjunction with the problem just mentioned is the fact that the OPEC quota of 15.8 million barrels per day does not apply to OPEC refinery operations of which there are a growing number. Hence, an increase in the output of refined products is taking place. This means more competition which should theoretically lead to lower prices for the finished product. This in turn translates into less demand for crude which means downward pressure on prices.

If arguments one through eight are considered as a whole, then the potential for oil prices faltering if not dropping is tremendous.

#### The Politics

1. The incentives for the thirteen member OPEC group to hold together their agreement of December 21, 1986 and even adjust it if necessary to insure success are fairly clear-cut. All members are experiencing a negative cash flow situation and some are deeply indebted to the other countries and the world banking system. Coupled with this is the fact that since 1982, with the drop in the price of oil, economic stagnation has plagued most of these countries. The political pressures from within these countries to rectify the situation are tremendous. But OPEC's struggle to succeed in holding together their December accord is fraught by divergent economic, religious, political and financial interests.
2. The Saudis have once again adopted the role of swing producer (i.e. adjusted output below their 4.1 million barrel per day quota in order to make the OPEC agreement viable) but we believe this is only temporary in light of their monetary situation. In fact, as I write this, the latest data available suggests that Saudi Arabia is producing at or close to their quota of 4.1 million barrels per day. They currently have the capability to produce more than twice this amount. The Saudis' projected deficit this year is expected to be \$15 billion and they are rapidly drawing down their liquid assets. Their resolve to hold the line is there but they do not have the resources to continue much longer. More production cuts may be necessary if OPEC is to maintain its current price structure, but the economic realities may limit Saudi Arabia's ability to play the key role that it has in the past. And it must be kept in mind that Saudi Arabia is the only member of OPEC who has consistently assumed this responsibility in the past.

The irony of this whole thing is that Saudi Arabia with its vast reserves (publicly known proven reserves are in excess of 167 billion barrels of oil) of low cost oil has the ability to flood world markets thus forcing out higher cost competitors in the process. The end result would be plunging oil prices but the Saudi's revenues would increase. Holding them in check at this stage of the game is the threat of aggression on the part of some of their neighbors who would be severely damaged economically, financially, and politically if the Saudis were to initiate such a plan.

3. The Iran/Iraq war is a thorn in the side of all concerned. The Iraqis absolutely refuse to go along with their allotted quota of 1.466 million barrels per day and are currently producing between 1.8 and 2 million barrels per day. This excludes production from the Saudi and Kuwaiti Neutral Zone which is utilized to finance the Iraq war. Moreover, a new pipeline from the northern part of the country across Turkey to the Mediterranean Sea is scheduled for completion this winter and will add an additional 500,000 barrels a day to Iraq's export capacity. Iraq also plans to build a second line to the Red Sea port of Yanbu in addition to the one just completed. This new line is expected to pump an additional 1.6 million barrels per day, 18 months from now. In view of the war effort and their indebtedness to the Saudi and Kuwait governments, Iraq has no choice but to go all out. It is literally a matter of survival.

On the other hand if Iraq and Iran settle their war, production from these two countries could increase even more dramatically in an effort to rebuild their shattered economies.

4. After countless discussions over an extended period of time, OPEC has persuaded many non-OPEC countries that it is to their benefit to assist in the overall effort to control oil markets. Hence, the Soviet Union, Egypt, Norway, Mexico and others have contributed in some form or fashion but this support is wavering. And for some countries such as Mexico with large excess oil producing capacity and on the verge of financial collapse, except for the aid of the international banking system, the situation is highly intolerable.
5. The next OPEC meeting scheduled for the latter part of June will be a test to see if the current OPEC agreement survives. One of the major problems confronting OPEC, which Saudi Arabia and others recognize, is the confidence on the part of some that the problem has been resolved and that OPEC is once again in control. Hence, some members are demanding that a higher official price be established. Others such as the UAE are demanding that their respective quotas be increased and if not, they will increase production regardless. The UAE is one of those OPEC members that has been a chronic cheater this last year. Although third quarter OPEC quotas are scheduled to increase to 16.6 million barrels per day, the fundamentals of supply and demand do not support the current agreement let alone the additional demands of member countries or the increased production scheduled shortly to come on-line. Hence, in the last few weeks we have observed the more responsible members of OPEC attempting to prevail upon those less responsible to stay with the current agreement. The responsible members of OPEC are cognizant of the fact that the current agreement could come completely unraveled, and to ask for more is pushing the whole situation to the brink where once again the specter of plunging oil prices could become a reality.

Off to the sidelines are the non-OPEC countries confronted by their own economic, political, and financial problems, closely watching and doubting OPEC's resolve. Many of these countries refuse to make further concessions and are waiting to decipher the results of the next OPEC meeting. Even then, assuming a favorable OPEC accord, some of these countries might quietly seize the opportunity to move in and take advantage of the situation as they have so often in the past and abandon their own agreements with OPEC. The end result, of course, would be to undermine any OPEC accord.

### The Conclusions

What does the above thumbnail sketch boil down to? It is quite obvious that there are few if any economic fundamentals suggesting that prices will continue to increase and many reasons why they might decrease. The situation is one where OPEC actions, via delicate political maneuvering to control supply and demand, serve to bolster prices. And this is an area where the cohesiveness of OPEC, as alluded to above, is beset by problems.

What does this portend relative to oil prices? Will they increase? If OPEC can restrain individual members from engaging in widespread violations of the current agreement, if non-OPEC countries continue to offer both tacit and overt support, if worldwide demand for petroleum products does not reverse itself, and if inventories are reduced throughout the summer, then prices should steady and perhaps increase next winter. But the professional traders who put their money on the line are betting that prices will drop this winter as is evident by trading in the futures market. This means that prudence dictates a cautious approach relative to the State's spending plans.

Having considered the aforementioned economic and political factors, plus pro and con arguments that I will not elaborate on here, and using what available data we have acquired since the last forecast to run through our computer models, the results of our analysis are outlined below.

The updated unrestricted revenue numbers are \$1,674.1 million, \$1,716.1 million, and \$1,672.1 million for FY 87, FY 88, and FY 89 respectively. The changes, when compared to the March forecast, represent increases of \$75.7 million, \$183.5 million, and \$82.4 million for FY 87, FY 88 and FY 89 respectively.

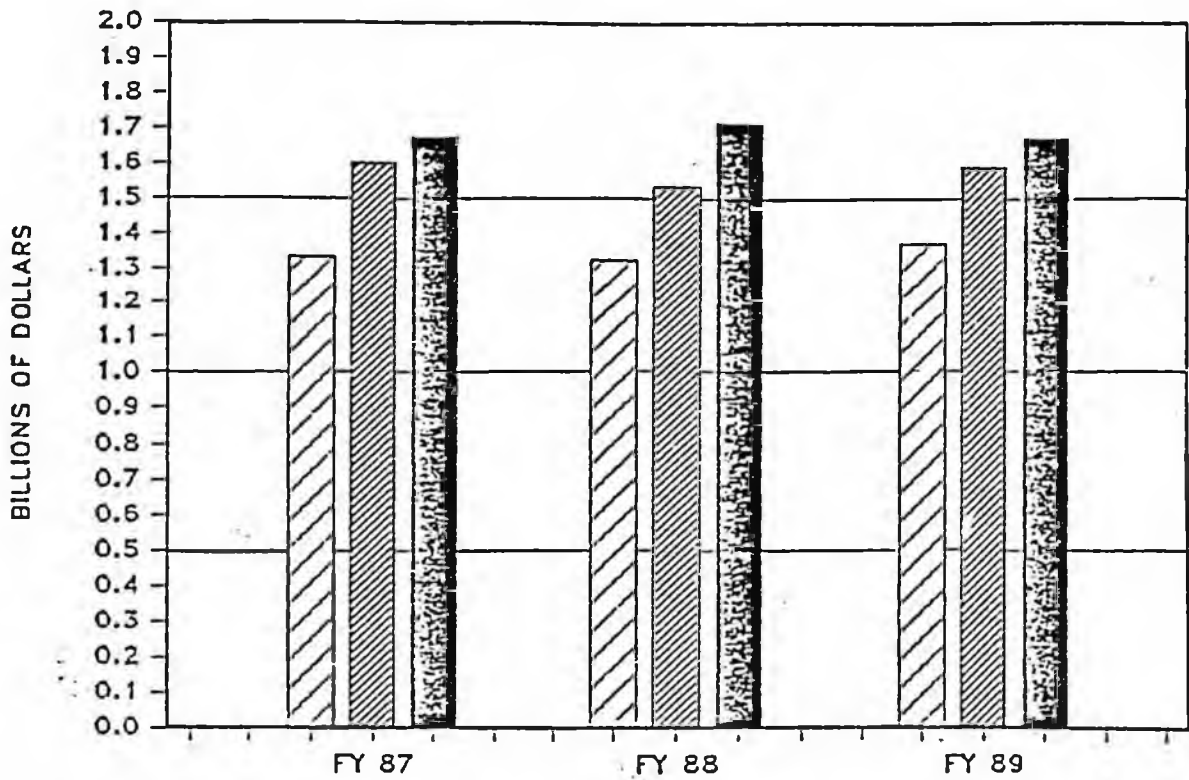
The FY 87 number must be adjusted upward by \$67.2 million for TAPS legal expenses and refunds. When this adjustment is made, the bottom line for FY 87 then amounts to \$1,741.3 million.

Please note that the FY 87 number represents the mean case whereas the figures for FY 88 and FY 89 represent the more conservative 30% case.

I have attached for your perusal the details of this forecast along with the basic underlying assumptions, a short history of the State's revenue picture, and charts indicating the nominal versus real dollar outlook.

FIGURE 1  
**GENERAL FUND UNRESTRICTED REVENUES**  
 (COMPARISON OF PRIOR FORECASTS)

JANUARY 1987 ESTIMATES  
 MARCH 1987 ESTIMATES  
 JUNE 1987 ESTIMATES



FY 87 Estimates

January 1987	1.3342 billion
March 1987	1.5984 billion
June 1987	1.6741 billion

FY 88 Estimates

January 1987	1.3250 billion
March 1987	1.5326 billion
June 1987	1.7161 billion

FY 89 Estimates

January 1987	1.3739 billion
March 1987	1.5897 billion
June 1987	1.6721 billion

\* IT SHOULD BE NOTED THAT ALL "SPECIAL SETTLEMENTS" HAVE BEEN EXCLUDED IN FY 87 IN ORDER TO BE CONSISTENT IN COMPARING PRIOR FORECASTS. THE FY 87 BOTTOM LINE WOULD INCLUDE AN ADDITIONAL \$65.7 MILLION (TAPS REFUNDS/LEGAL EXPENSES) AND \$1.5 MILLION (ARCO COURT COSTS).

TABLE I  
General Fund Unrestricted Revenues  
(Thousands of Current Dollars)

<u>Taxes</u>	FY 1987 Estimate <u>June</u>	FY 1988 Estimate <u>June</u>	FY 1989 Estimate <u>June</u>
<u>Income</u>			
Corporate-General	14,000	15,000	15,500
Corporate-Petroleum	95,000	110,000	110,000
<u>Gross Receipts</u>			
Alaska Business License	2,000	2,000	2,000
Fish-Canned/Shorebased (1)	16,600	8,800	8,800
Fish-Floating	9,000	8,000	8,000
Seafood Marketing	1,400	1,200	1,200
Salmon Enhancement	4,200	3,800	3,800
Insurance Companies	23,600	22,000	21,000
Electric & Telephone Co-ops	1,900	1,900	1,900
Mining License Tax	300	400	400
<u>Severance</u>			
Oil & Gas Production (2)	624,300	637,900	630,400
Oil & Gas Conservation	800	700	700
<u>Property</u>			
Oil & Gas	109,000	80,000	71,000
<u>Sale/Use</u>			
Alcoholic Beverages	12,800	12,300	12,000
Fuel Taxes-Aviation (3)	8,100	7,800	7,700
Fuel Taxes-Highway (3)	17,500	18,900	18,700
Fuel Taxes-Marine (3)	5,000	4,700	4,600
Tobacco Products	6,600	6,400	6,300
<u>Other</u>			
Estate	1,100	700	700
Total Taxes	<u>953,200</u>	<u>942,500</u>	<u>924,700</u>
<u>Licenses &amp; Permits</u>			
Business (4)	9,500	9,800	9,800
Non-business	20,000	21,000	21,000
Total Licenses & Permits	<u>29,500</u>	<u>30,800</u>	<u>30,800</u>
<u>Intergovernmental Receipts</u>			
Federal Shared Revenues (5)	8,800	8,500	8,500
<u>State Resource Revenue</u>			
<u>Sale/Use</u>			
Bonus Sales (5) (6) (7) (8)	2,500	-0-	-0-
Investment Earnings (9)	160,000	100,000	65,000
Rents (5) (6) (7) (8)	5,500	6,000	6,500
Royalties (2) (5)	437,900	556,200	562,900
Sale of State Property	8,000	9,000	9,000
Gravel, Timber, etc. (10)	8,000	2,500	2,500
<u>Facilities Related Charges</u>			
Airports	1,600	1,600	1,600
Ferry System-Southeast	29,000	30,000	31,200
Ferry System-Southwest	3,800	3,900	4,000
Other	5,000	5,000	5,000

Service Related Charges

Court System	5,300	5,400	5,600
Other	6,000	4,700	4,800
Total State Resources			
Revenues	672,600	724,300	698,100
Miscellaneous Revenues	10,000	10,000	10,000
Unrestricted Revenues	1,674,100	1,716,100	1,672,100
Plus: Special Settlements (11)	67,200	-0-	-0-
Total Unrestricted Revenues (12)	1,741,300	1,716,100	1,672,100

(1) The FY 88 and FY 89 figures reflect the recent enactment of a shorebased fisheries business tax credit per Ch. 79, SLA 1986, effective July 1, 1986. The canned fisheries business tax has been combined into a single category with the shorebased since the tax credits are applied against the aggregate return and cannot be allocated by specific processing type.

(2) The FY 87 forecast assumes the mean case. The forecasted numbers for FY 88 and FY 89 assume the 30 percent case; however, if the mean case had been utilized for FY 88 and FY 89, the production taxes would change to \$717.9 million and \$732.3 million, respectively. The royalty figures would change to \$626.3 million and \$666.8 million respectively. All of the forecasted numbers include the estimated TAPS settlement.

(3) In FY 86 and FY 87 the Department of Revenue began to levy marine fuel taxes on watercraft motor fuel users who purchased fuel out-of-state but consumed fuel in transit through the state. On March 30, 1987, the State adopted hearing decision #87-07 which established that marine fuel users who merely consumed fuel in transit could not be retroactively taxed. In line with this decision, the Department of Revenue is refunding with interest any taxes collected under the earlier interpretation. This forecast estimates that refunds plus interest will total \$1.8 million and assumes that the majority of these refunds will be paid in FY 87. All motor fuel tax refunds are paid from the Highway Fuel Tax Account.

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(9) The investment earning projections presented reflect the current composition of General Fund assets and current interest rates. The projections also reflect a drawdown in the level of the General Fund assets over the projection period. The projected drawdown in assets is a result of projected revenue cash inflows consistent with the current revenue forecast and projected expenditure cash outflows consistent with the estimated FY 88 operating budget which was passed by the Legislature before any gubernatorial vetoes. Also, no capital budget appropriations for FY 88 were factored into the expenditure cash outflow projection because no capital budget was passed by the Legislature.

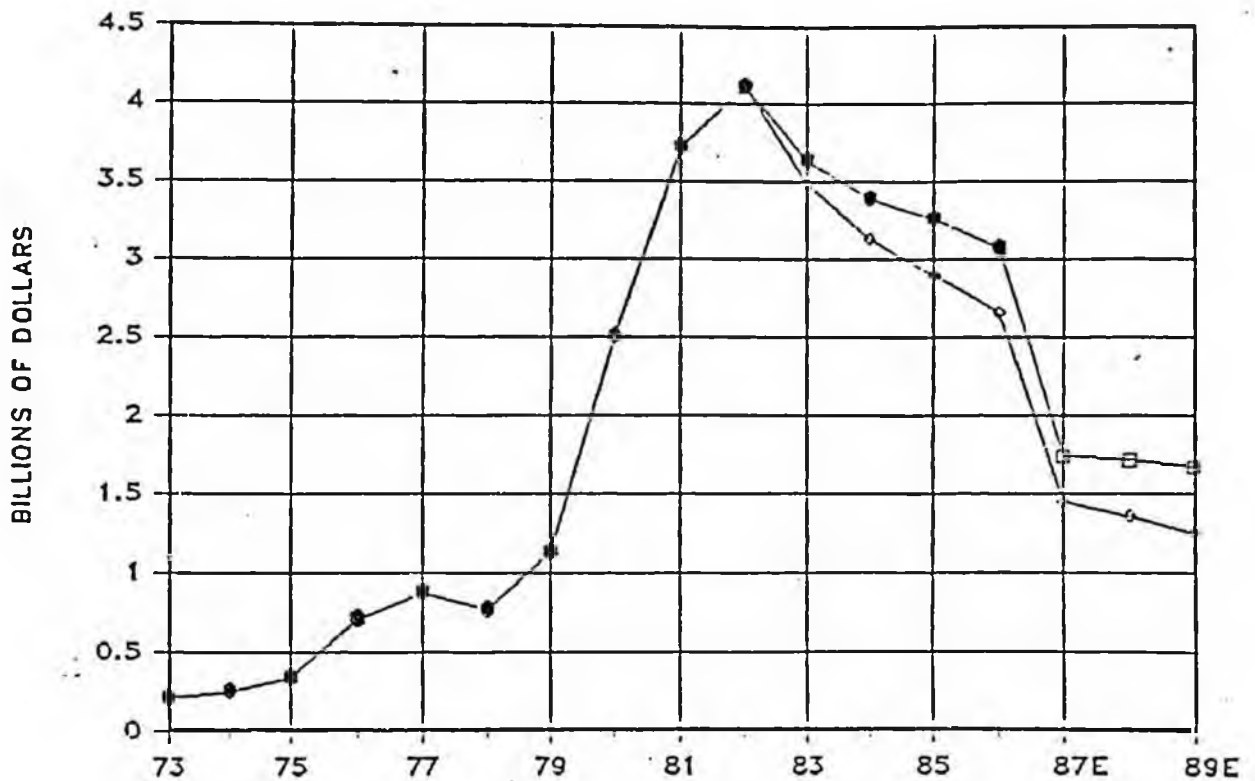
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(11) The FY 87 figure reflects the estimated General Fund portion from refunds and expenses for prior years relative to the TAPS case (\$65.7 million) and court costs relative to the ARCO settlement (\$1.5 million). Consequently, \$67.2 million is projected to be received during FY 87, but this figure is subject to future audits.

(12) The State, per AS 38.05.180, will be granting incentive credits against royalties, severance taxes, and rentals to the oil companies for drilling exploratory wells. The deduction is approximately \$2.9 million which has not been subtracted from the aforementioned FY 87 figure of \$1,741.3 million. Additional credits are anticipated in subsequent years.

FIGURE 2  
**GENERAL FUND UNRESTRICTED REVENUES**  
 (NOMINAL DOLLARS VS. REAL DOLLARS)

- ACTUALS(NOM\$)
- ESTIMATES(NOM\$)
- ◇ ACT/EST(REAL\$/1982)



Revenue Actuals  
(Nominal \$)

FY 73	.2082 billion
FY 74	.2549 billion
FY 75	.3334 billion
FY 76	.7098 billion
FY 77	.8743 billion
FY 78	.7649 billion
FY 79	1.1330 billion
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FY 82	4.1084 billion
FY 83	3.6310 billion
FY 84	3.3901 billion
FY 85	3.2600 billion
FY 86	3.0755 billion

Revenue Estimates  
(Nominal \$)

FY 87	1.7413 billion
FY 88	1.7161 billion
FY 89	1.6721 billion

Revenue Actuals/Estimates  
(Real \$/1982)

FY 82	4.1084 billion
FY 83	3.4826 billion
FY 84	3.1347 billion
FY 85	2.9002 billion
FY 86	2.6584 billion
FY 87	1.4532 billion
FY 88	1.3587 billion
FY 89	1.2559 billion

TABLE II

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 For FY 1987 - FY 1989

<u>Fiscal Year</u>	<u>(\$/bbl) Mean Wellhead Value</u>	<u>(\$/bbl) 30% Wellhead Value</u>	<u>Mean TAPS Throughput (MMbbs/day)</u>	<u>Mean Rate Inflation %</u>
1987	\$7.22	\$7.05	1.84	3.59
1988	\$9.90	\$8.81	1.87	5.41
1989	\$10.44	\$8.84	1.89	5.42

Sales Price for Alaska North Slope Crude Oil at Los Angeles, California

	<u>Weighted Average</u>	<u>30% Case</u>	
FY 87	\$13.16	\$12.99	per barrel
FY 88	\$14.70	\$13.61	per barrel
FY 89	\$14.83	\$13.23	per barrel

Sales Price for Alaska North Slope Crude Oil at Houston, Texas

	<u>Weighted Average</u>	<u>30% Case</u>	
FY 87	\$14.38	\$14.21	per barrel
FY 88	\$15.89	\$14.80	per barrel
FY 89	\$16.04	\$14.44	per barrel

Weighted Average TAPS Tariff

FY 87	\$4.25	per barrel
FY 88	\$3.59	per barrel
FY 89	\$2.84	per barrel

# MEMORANDUM

# State of Alaska

TO: The Honorable Steve Cowper  
Governor

DATE: March 20, 1987

THRU: Hugh Malone *H. Malone*  
Commissioner of Revenue

FILE NO.:

TELEPHONE NO.: 465-2173

FROM: Vincent D. Wright *V. Wright*  
Chief of Research  
Department of Revenue

SUBJECT: March Revenue Forecast

The March 1987 unrestricted revenue forecast is complete and the numbers for FY 87, FY 88, and FY 89 are \$1,598.4 million, \$1,532.6 million, and \$1,589.7 million respectively.

The changes when compared to the January 1987 forecast represent increases of \$264.2 million, \$207.6 million, and \$215.8 million for FY 87, FY 88, and FY 89 respectively.

The FY 87 number must be adjusted upward by \$65 million for TAPS legal expenses and refunds. When this adjustment is made, the bottom line for FY 87 then amounts to \$1,663.4 million.

The FY 87 number represents the mean case, which is traditionally adopted this time of the year, whereas the figures for FY 88 and FY 89 represent the more conservative 30% case.

The situation relative to the oil outlook is extremely volatile and will likely remain so throughout the spring and summer. The problem centers around whether or not the fundamentals of supply and demand support current crude prices. The evidence to date suggests that they do not. The political side of the equation, mainly what oil producing OPEC and non-OPEC countries can do in controlling markets, is the primary factor propping up oil prices and this effort is tenuous at this particular point in time. The fact of the matter is that OPEC is undergoing, at this moment, a testing period insofar as its ability to hold together the production and pricing agreement reached December 21, 1986.

The most formidable and immediate problem working to undermine the OPEC agreement is the unwillingness of buyers to purchase the desired level of 15.8 million barrels per day at \$18/barrel that OPEC would like to sell, although this in itself should help to reduce the excess supply of crude on world markets. The OPEC group is also confronted by the anticipated normal spring seasonal downturn in demand for certain types of fuel, the excess oil productive capacity of OPEC and non-OPEC countries alike, the relative decline in the value of the dollar which OPEC oil is pegged to, and adverse cash flow problems. The demand for petroleum products worldwide is sluggish at best with little chance for improvement in the immediate future. Compounding the problem is the price competitiveness of substitute energy resources. All the

aforementioned factors, which primarily revolve around the fundamentals of supply and demand, militate against OPEC being able to prevent, via political means, a collapse in oil prices.

On the other hand, if OPEC can restrain individual members from engaging in widespread violations of the current agreement, if non-OPEC countries continue to offer both tacit and overt support, if worldwide demand for petroleum products does not reverse itself, and if inventories are reduced throughout the spring and summer, then prices should steady and perhaps increase next winter. The odds against OPEC being able to hold their agreement together are enormous but we believe their chances of succeeding are better now than they were a few months ago. The one crucial element favoring success centers around OPEC's absolute necessity to succeed or confront as a consequence internal economic and financial failure. The prospect of this type of failure is perhaps the strongest motive holding OPEC together at this time. I want to reemphasize, however, that the situation is still tenuous and will likely remain so throughout the summer. This means that prudence dictates a cautious approach relative to our budgetary difficulties.

I should mention at this juncture that the numbers in this forecast are not based on any new revenue raising measures that might be passed during this session. If such measures are past, then the numbers will have to be adjusted accordingly.

I would like to further add the caveat that if there is a margin for error in this particular forecast it is obviously on the optimistic side i.e. the downside risks are much greater than any perceived upside potential.

I have attached for your perusal the details of this forecast along with the basic underlying assumptions, a short history of the states revenue picture, and charts indicating the nominal versus real dollar outlook.

VDW:mll  
Attachments

TABLE I  
General Fund Unrestricted Revenues  
(Thousands of Current Dollars)

<u>Taxes</u>	FY 1986 Actual March	FY 1987 Estimate March	FY 1988 Estimate March	FY 1989 Estimate March
<u>Income</u>				
Corporate-General	11,200	14,000	15,000	15,500
Corporate-Petroleum	133,900	95,000	110,000	110,000
<u>Gross Receipts</u>				
Alaska Business License	2,100	2,000	2,000	2,000
Fish-Canned Salmon (1)	3,500	2,500	2,300	2,300
Fish-Shorebased (1)	10,100	11,500	10,000	10,000
Fish-Filleting	7,500	8,000	7,600	7,600
Seafood Marketing	1,100	1,300	1,200	1,200
Salmon Enhancement	4,300	4,000	4,000	4,000
Insurance Companies(2)	21,100	18,500	18,200	17,900
Electric & Telephone Co-ops	1,900	1,900	1,900	1,900
Mining License Tax	300	300	400	400
<u>Severance</u>				
Oil & Gas Production (3)	1,107,900	598,200	549,100	597,100
Oil & Gas Conservation	500	800	700	700
<u>Property</u>				
Oil & Gas	113,500	82,700	76,800	70,700
<u>Sale/Use</u>				
Alcoholic Beverages	13,300	12,800	12,300	12,000
Fuel Taxes-Aviation (4)	8,100	7,900	7,800	7,700
Fuel Taxes-Highway (4)	22,700	19,500	19,000	18,700
Fuel Taxes-Marine (4)	5,300	4,700	4,500	4,400
Tobacco Products (5)	4,900	6,900	6,600	6,400
<u>Other</u>				
Estate	700	1,100	700	700
<b>Total Taxes</b>	<b><u>1,473,900</u></b>	<b><u>893,600</u></b>	<b><u>850,100</u></b>	<b><u>891,200</u></b>
 <u>Licenses &amp; Permits</u>				
<u>Business</u>	11,300	10,500	10,800	11,000
<u>Non-Business (6)</u>	18,000	21,000	21,000	21,000
<b>Total Licenses &amp; Permits</b>	<b><u>29,300</u></b>	<b><u>31,500</u></b>	<b><u>31,800</u></b>	<b><u>32,000</u></b>
 <u>Intergovernmental Receipts</u>				
Federal Shared Revenues (7)	<u>14,500</u>	<u>8,800</u>	<u>8,500</u>	<u>8,500</u>
 <u>State Resource Revenue</u>				
<u>Sale/Use</u>				
Bonus Sales (7) (8) (9) (10)	34,700	2,500	-0-	-0-
Investment Earnings (11)	195,200	160,000	90,000	45,000
Rents (7) (8) (9) (10)	6,200	5,500	6,000	6,500
Royalties (3) (7)	856,100	419,900	476,300	536,300
Sale of State Property	8,700	8,000	9,000	9,000
Gravel, Timber, etc. (12)	2,900	8,000	2,500	2,500
<u>Facilities Related Charges</u>				
Airports	1,500	1,600	1,600	1,600
Ferry System-Southeast	28,500	29,000	28,000	28,000
Ferry System-Southwest	3,800	3,800	3,700	3,700
Other	5,200	5,000	5,000	5,000

Service Related Charges

Court System	5,100	5,300	5,400	5,600
Other	4,100	6,000	4,700	4,800
<u>Total State Resources</u>				
Revenues	1,152,000	654,500	632,200	648,000
<u>Miscellaneous Revenues</u>	13,000	10,000	10,000	10,000
<u>Unrestricted Revenues</u>	2,682,700	1,598,400	1,532,600	1,589,700
Plus: Special Settlements (13) (14)	392,800	65,000	-0-	-0-
<u>Total Unrestricted Revenues (15)</u>	3,075,500	1,663,400	1,532,600	1,589,700

(1) The FY 87, FY 88, and FY 89 figures reflect the recent enactment of a shorebased fisheries business tax credit per Ch. 79, SLA 1986. The Act took effect July 1, 1986.

(2) The FY 87, FY 88, and FY 89 figures reflect the enactment of Ch. 118, SLA 1986 which set the tax for domestic and foreign insurers, except hospital and medical service corporations, at 2.7 percent. Previously domestic and foreign insurers were taxed at 1.5 percent and 3.0 percent.

(3) The January forecast for FY 87 assumed the 30 percent case; however, the FY 87 March estimates have been changed to reflect the mean or average case. The forecasted numbers for FY 88 and FY 89 continue to assume the 30 percent case; however, if the mean case had been utilized for FY 88 and FY 89, the production taxes would change to \$663.2 million and \$724.0 million, respectively. The royalty figures would change to \$575.9 million and \$666.2 million, respectively. All of the forecasted numbers include the estimated TAPS settlement.

(4) Revenues from the three main categories of fuel tax are shown separately. However, under the provisions of AS 43.40.010(h), all refunds are made from the highway fuel tax account. If gross collections of highway fuel taxes remain constant, an increase in refunds for aviation and marine fuels could lower the net revenues shown for highway fuels. Also, increasing use is being made of tax credits, which can be taken in lieu of claiming a refund on certain non-taxable use of fuel (15 AAC 40.200). The FY 86 figure includes revenue for marine fuel tax collections on fuel purchased out-of-state but which is used in Alaska waters. A number of returns for taxes levied on in-state usage are currently in the appeal process and FY 87, FY 88, and FY 89 revenues will not be revised upward until that process is completed.

(5) Ch. 24, SLA 1985 raised the General Fund portion of the cigarette tax from a rate of 1-1/2 mills (\$.0015) to 5-1/2 mills (\$.0055) per cigarette. The Act took effect October 1, 1985.

(6) The FY 87, FY 88 and FY 89 figures reflect the enactment of Ch. 60, SLA 1986 which increased driver licensing fees and vehicle registration fees. The Act became effective September 1, 1986.

(7) Net Permanent Fund contribution by Ch. 18 SLA 1980.

(8) Reflects state lease sales of \$16.3 million held September 24, 1985 (Sale 45A-North Slope Onshore and Sale 47 - Kuparuk Uplands), \$3.0 million held February 25, 1986 (Sale 48 - Kuparuk Uplands and Sale 48A - Mikkelsen), \$0.9 million held June 24, 1986 (Sale 49 - Cook Inlet), and \$0.3 million held January 27, 1987 (Sale 51 - Prudhoe Bay Uplands). Due to the timing of collections, receipts from the June 1986 lease sale are shown as FY 87 revenue. The FY 87, FY 88, and FY 89 bonus figures represent the General Fund's 49.5 percent share.

(9) The FY 86 figure reflects the DCS "8(g)" revenue-sharing settlement of \$51.4 million. The General Fund share represents 49.5 percent of the aforementioned total, whereas the Permanent Fund will receive 50.0 percent. The remaining 0.5 percent will be distributed to the Public School Fund. An additional \$4.0 million is reflected in FY 87.

(10) The Department of Natural Resources projects the following FY 87, FY 88, and FY 89 state lease sales: FY 87 (Sale 50 - Camden Bay); FY 88 (Sale 54 - Kuparuk Upland, Sale 55 - Demarcation Point); and FY 89 (Sale 52 - Beaufort Sea, Sale 56 - Alaska Peninsula). However, bonus bids are impossible to anticipate prior to sales; therefore, no estimates are provided.

(11) The investment earning projections presented reflect the current composition of General Fund assets and current interest rates. The projections also reflect a drawdown in the level of General Fund assets over the projection period. The projected drawdown in assets is a result of projected revenue cash inflows consistent with the current revenue forecast and projected expenditure cash outflows consistent with the revised FY 87 budget and the Governor's, January 1987, recommended FY 88 budget. None of the Governor's proposed revenue enhancement or alternative funding measures have been reflected in the projections. Should proposed tax measures be enacted or should a portion of the Permanent Fund earnings be appropriated to the General Fund then these General Fund investment earning projections would be greater for FY 88 and FY 89.

(12) The FY 87 estimate reflects increased construction of roads and drilling pads as projected by the Department of Natural Resources.

(13) The FY 86 figure includes the \$243 million the State received from the ARCO settlement on January 15, 1986.

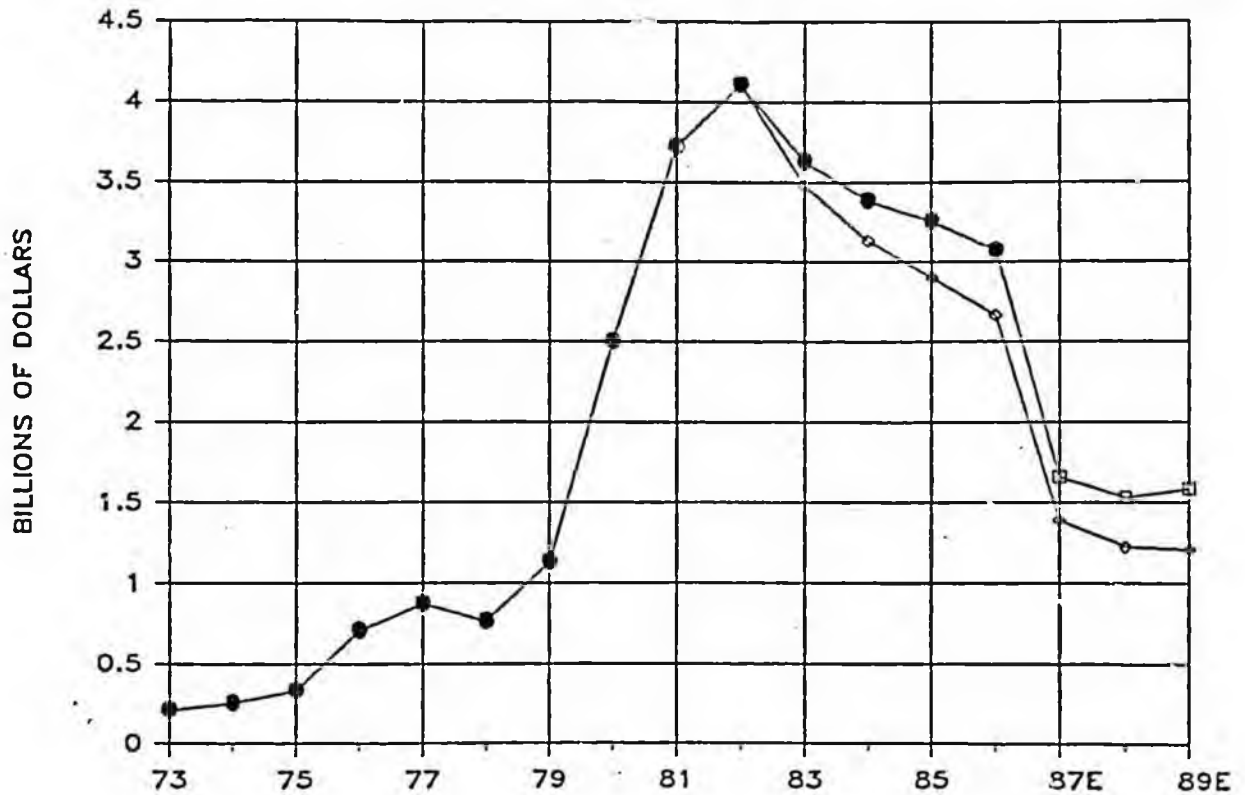
(14) The FY 86 and FY 87 figures reflect the estimated General Fund portion from refunds and expenses for prior years, relative to the TAPS case. The State received \$149.8 million during FY 86 but this figure is subject to audit. Approximately \$65.0 million is projected to be received during FY 87. This figure is also subject to future audits.

(15) The State, per AS 38.05.180, will be granting incentive credits against royalties, severance taxes, and rentals to the oil companies for drilling exploratory wells. The deduction is approximately \$0.7 million which has not been subtracted from the aforementioned FY 86 figure of \$3,075.5 million and approximately \$2.5 million which has not been subtracted from the aforementioned FY 87 figure of \$1,663.4 million. Additional credits are anticipated in subsequent years.



FIGURE 2  
**GENERAL FUND UNRESTRICTED REVENUES**  
 (NOMINAL DOLLARS VS. REAL DOLLARS)

- ACTUALS(NOM\$)
- ESTIMATES(NOM\$)
- ◇ ACT/EST(REAL\$/1982)



**Revenue Actuals**  
(Nominal \$)

FY 73	.2082 billion
FY 74	.2549 billion
FY 75	.3334 billion
FY 76	.7098 billion
FY 77	.8743 billion
FY 78	.7649 billion
FY 79	1.1330 billion
FY 80	2.5012 billion
FY 81	3.7182 billion
FY 82	4.1084 billion
FY 83	3.6310 billion
FY 84	3.3901 billion
FY 85	3.2600 billion
FY 86	3.0755 billion

**Revenue Estimates**  
(Nominal \$)

FY 87	1.6634 billion
FY 88	1.5326 billion
FY 89	1.5897 billion

**Revenue Actuals/Estimates**  
(Real \$/1982)

FY 82	4.1084 billion
FY 83	3.4826 billion
FY 84	3.1347 billion
FY 85	2.9002 billion
FY 86	2.6641 billion
FY 87	1.3926 billion
FY 88	1.2258 billion
FY 89	1.2126 billion

TABLE II

Key Assumptions for March 1987  
 Petroleum Revenue Projections  
 For FY 1987 - FY 1989

<u>Fiscal Year</u>	<u>(\$/bbl) Mean Wellhead Value</u>	<u>(\$/bbl) 30% Wellhead Value</u>	<u>Mean TAPS Throughput (MMbbs/day)</u>	<u>Mean Rate Inflation %</u>
1987	\$6.93	\$6.61	1.83	3.47
1988	\$9.11	\$7.56	1.87	4.68
1989	\$10.40	\$8.40	1.89	4.85

Sales Price for Alaska North Slope Crude Oil at Los Angeles, California

	<u>Weighted Average</u>	<u>30% Case</u>	
FY 87	\$12.83	\$12.51	per barrel
FY 88	\$14.09	\$12.54	per barrel
FY 89	\$14.87	\$12.87	per barrel

Sales Price for Alaska North Slope Crude Oil at Houston, Texas

	<u>Weighted Average</u>	<u>30% Case</u>	
FY 87	\$14.06	\$13.74	per barrel
FY 88	\$15.16	\$13.61	per barrel
FY 89	\$16.00	\$14.00	per barrel

Weighted Average TAPS Tariff

FY 87	\$4.25	per barrel
FY 88	\$3.19	per barrel
FY 89	\$2.75	per barrel

# MEMORANDUM

# State of Alaska

TO: The Honorable Steve Cowper  
Governor of Alaska

DATE: December 3, 1986

FILE NO.:

THRU:

TELEPHONE NO.: 465-2173

SUBJECT: January Revenue Forecast

FROM: Vincent D. Wright *VW*  
Chief of Research  
Department of Revenue

The January 1987 unrestricted revenue forecast is complete and the numbers for FY 87, FY 88 and FY 89 are \$1,334.2 million, \$1,325.0 million, and \$1,373.9 million respectively. The numbers mentioned above are based on the 30% or more conservative case when compared to the mean case.

The changes when compared to the September forecast represent a decrease of \$74.4 million for FY 87, but increases of \$51.4 million and \$111.4 million for FY 88 and FY 89.

For FY 87, when the expected \$65 million in TAPS legal expenses and refunds is added, the bottom line then becomes \$1,399.2 million.

The books have now been closed for FY 86 and the total unrestricted revenues for that year, not including special settlements, amount to \$2,682.7 million. This number for FY 86 must be adjusted for two items. The first deals with the fact that we have received in the General Fund \$149.8 million in legal expenses and refunds from the TAPS case. The second is the receipt on January 15, 1986 of \$243 million for the ARCO settlement. When the \$149.8 million and \$243 million are added to FY 86, the bottom line then becomes \$3,075.5 million.

The current situation relative to the oil picture is such that the underlying economic fundamentals of supply and demand do not support current price levels. The political element, OPEC control or lack of control, is primarily responsible for today's "relatively high priced oil". Since the political element supercedes the economic factor we must continue to expect a great deal of volatility in oil markets. This type of activity can whipsaw an economy such as ours.

The period we have to be most concerned about now is the spring of 1987. If large inventories persist, if normal seasonal factors prevail, and if it is perceived by oil traders that OPEC is having difficulty holding together its current agreement (due to expire at the end of December but expected to be renewed), then oil prices could plunge dramatically. We anticipate, in any case, a "normal drop" in oil prices this spring due to historical seasonal patterns but whether a total collapse occurs depends on OPEC's ability to hold together their current

The Honorable Steve Cowper  
December 3, 1986  
Page 2

agreement. In view of the internal dissension plaguing the OPEC membership, the outlook is not encouraging. I would like to further add the caveat that if there is a margin for error in this particular forecast we believe it is on the optimistic side i.e. the downside risks are much greater than any perceived upside potential.

I have attached eight letters written over the last two years to your predecessor on the subject of the State's oil outlook. These letters lay out in detail the unfolding of events in the world oil arena. You may find them interesting reading.

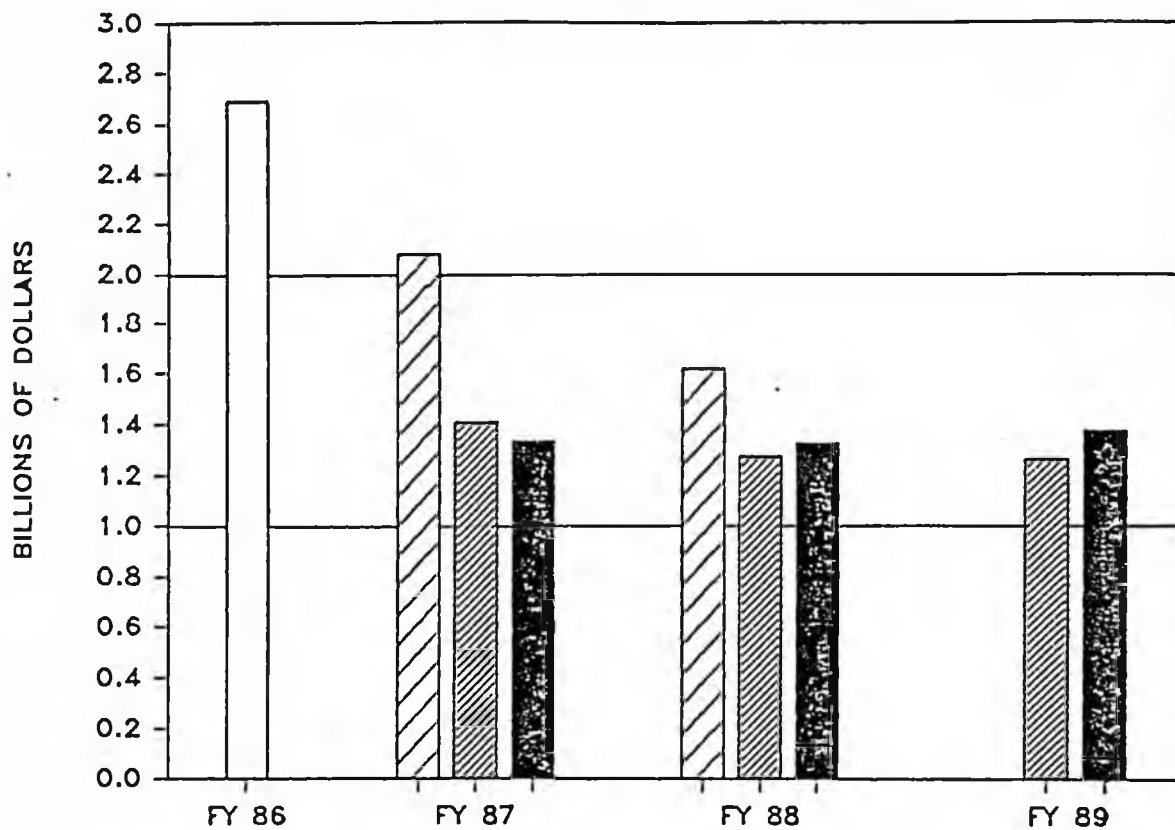
I have also attached for your perusal the details of this forecast along with the basic underlying assumptions, a short history of the State's revenue picture, and charts indicating the nominal versus real dollar outlook.

VDW:mkw

Attachments

FIGURE 1  
**GENERAL FUND UNRESTRICTED REVENUES**  
 (COMPARISON OF PRIOR FORECASTS)

- FY 86 ACTUAL
- ▨ MARCH 1986 ESTIMATES
- ▩ SEPTEMBER 1986 ESTIMATES
- JANUARY 1987 ESTIMATES



\* IT SHOULD BE NOTED THAT THE ABOVE AMOUNTS DO NOT INCLUDE ANY SPECIAL SETTLEMENTS. THE FY 86 BOTTOM LINE WOULD INCLUDE AN ADDITIONAL \$243.0 MILLION (ARCO SETTLEMENT) AND \$149.8 MILLION (TAPS REFUNDS/LEGAL EXPENSES). FOR FY 87, THE ABOVE FIGURES WOULD INCLUDE AN ADDITIONAL \$65.0 MILLION (TAPS REFUNDS/LEGAL EXPENSES).

TABLE I  
General Fund Unrestricted Revenues  
(Thousands of Current Dollars)

<u>Taxes</u>	<u>FY 1986 Actual January</u>	<u>FY 1987 Estimate January</u>	<u>FY 1988 Estimate January</u>	<u>FY 1989 Estimate January</u>
<u>Income</u>				
Corporate-General	11,200	14,000	15,000	15,500
Corporate-Petroleum	133,900	111,000	110,000	110,000
<u>Gross Receipts</u>				
Alaska Business License	2,100	2,000	2,000	2,000
Fish-Canned Salmon (1)	3,500	2,500	2,300	2,300
Fish-Shorebased (1)	10,100	11,500	10,000	10,000
Fish-Floating	7,500	8,000	7,600	7,600
Seafood Marketing	1,100	1,200	1,200	1,200
Salmon Enhancement	4,300	4,000	4,000	4,000
Insurance Companies(2)	21,100	20,000	19,600	19,200
Electric & Telephone Co-ops	1,900	1,900	1,900	1,900
Mining License Tax	300	300	400	400
<u>Severance</u>				
Oil & Gas Production (3)	1,107,900	459,200	453,900	493,600
Oil & Gas Conservation	500	700	600	600
<u>Property</u>				
Oil & Gas	113,500	82,700	76,800	70,700
<u>Sale/Use</u>				
Alcoholic Beverages	13,300	12,800	12,300	12,000
Fuel Taxes-Aviation (4)	8,100	8,000	8,000	8,000
Fuel Taxes-Highway (4)	22,700	20,500	20,000	20,000
Fuel Taxes-Marine (4)	5,300	4,100	4,100	4,100
Tobacco Products (5)	4,900	7,000	6,600	6,400
<u>Other</u>				
Estate	700	800	700	700
Total Taxes	<u>1,473,900</u>	<u>772,200</u>	<u>757,000</u>	<u>790,200</u>
 <u>Licenses &amp; Permits</u>				
<u>Business</u>	11,300	10,800	10,800	11,000
<u>Non-Business (6)</u>	18,000	21,000	21,000	21,000
Total Licenses & Permits	<u>29,300</u>	<u>31,800</u>	<u>31,800</u>	<u>32,000</u>
 <u>Intergovernmental Receipts</u>				
Federal Shared Revenues (7)	<u>14,500</u>	<u>8,500</u>	<u>8,500</u>	<u>8,500</u>
 <u>State Resource Revenue</u>				
<u>Sale/Use</u>				
Bonus Sales (7) (8) (9) (10)	34,700	2,400	-0-	-0-
Investment Earnings (11)	195,200	160,000	60,000	10,000
Rents (7) (8) (9) (10)	6,200	6,500	6,500	6,500
Royalties (3) (7)	856,100	277,100	390,200	455,400
Sale of State Property	8,700	8,500	9,000	9,000
Gravel, Timber, etc. (12)	2,900	8,000	2,500	2,500
<u>Facilities Related Charges</u>				
Airports	1,500	1,600	1,600	1,600
Ferry System-Southeast	28,500	29,000	29,000	29,000
Ferry System-Southwest	3,800	3,800	3,800	3,800
Other	5,200	5,000	5,000	5,000

Service Related Charges

Court System	5,100	5,300	5,400	5,600
Other	4,100	4,500	4,700	4,800
<b>Total State Resources</b>				
Revenues	1,152,000	511,700	517,700	553,200
<u>Miscellaneous Revenues</u>	<u>13,000</u>	<u>10,000</u>	<u>10,000</u>	<u>10,000</u>
<b>Total Unrestricted Revenues (13)(14)(15)</b>	<b>2,682,700</b>	<b>1,334,200</b>	<b>1,325,000</b>	<b>1,373,900</b>

(1) The FY 87, FY 88, and FY 89 figures reflect the recent enactment of a shorebased fisheries business tax credit per Ch. 79, SLA 1986. The Act took effect July 1, 1986.

(2) The FY 87, FY 88, and FY 89 figures reflect the enactment of Ch. 118, SLA 1986 which set the tax for domestic and foreign insurers, except hospital and medical service corporations, at 2.7 percent. Previously domestic insurers were taxed at a 1.5 percent rate and foreign insurers at 3.0 percent.

(3) The forecasted numbers for FY 87, FY 88, and FY 89 assume the 30 percent case; however, if the mean case had been utilized for FY 87, FY 88, and FY 89, the production taxes would change to \$504.6 million, \$581.3 million and \$649.5 million, respectively. The royalty figures would change to \$325.0 million and \$503.5 million, and \$600.2 million, respectively. All of the forecasted numbers include the estimated tariff adjustment from the TAPS settlement.

(4) Revenues from the three main categories of fuel tax are shown separately. However, under the provisions of AS 43.40.010(h), all refunds are made from the highway fuel tax account. If gross collections of highway fuel taxes remain constant, an increase in refunds for aviation and marine fuels could lower the net revenues shown for highway fuels. Also, increasing use is being made of tax credits, which can be taken in lieu of claiming a refund on certain non-taxable use of fuel (15 AAC 40.200). The FY 86 figure includes revenue for marine fuel tax collections on fuel purchased out-of-state but which is used in Alaska waters. A number of returns for taxes levied on in-state usage are currently in the appeal process and FY 87, FY 88, and FY 89 revenues will not be revised upward until that process is completed.

(5) Ch. 24, SLA 1985 raised the General Fund portion of the cigarette tax from a rate of 1-1/2 mills (\$.0015) to 5-1/2 mills (\$.0055) per cigarette. The Act took effect October 1, 1985.

(6) The FY 87, FY 88 and FY 89 figures reflect the recent enactment of Ch. 60, SLA 1986 which increased driver licensing fees and vehicle registration fees. The Act became effective September 1, 1986.

(7) Net Permanent Fund contribution by Ch. 18 SLA 1980.

(8) Reflects state lease sales of \$16.3 million held September 24, 1985 (Sale 45A-North Slope Onshore and Sale 47 - Kuparuk Uplands), \$3.0 million held February 25, 1986 (Sale 48 - Kuparuk Uplands and Sale 46A - Mikkelsen), and \$0.9 million held June 24, 1986 (Sale 49 - Cook Inlet). Due to the timing of collections, receipts from the June 1986 lease sale are shown as FY 87 revenue. The FY 87, FY 88, and FY 89 figures represent the General Fund's 49.5 percent share.

(9) The FY 86 figure reflects the OCS "8(g)" revenue-sharing settlement of \$51.4 million. The General Fund share represents 49.5 percent of the aforementioned total, whereas the Permanent Fund will receive 50.0 percent. The remaining 0.5 percent will be distributed to the Public School Fund. An additional \$4.0 million is reflected in FY 87.

(10) The Department of Natural Resources projects the following FY 87, FY 88, and FY 89 state lease sales: FY 87 (Sale 51 - Prudhoe Bay Uplands, Sale 50 - Camden Bay); FY 88 (Sale 54 - Kuparuk Upland, Sale 52A - Neclalik, Sale 55 - Demarcation Point); and FY 89 (Sale 52 - Beaufort Sea, Sale 56 - Alaska Peninsula). However, bonus bids are impossible to anticipate prior to sales; therefore, no estimates are provided.

(11) The FY 88 estimate for investment earnings assumes that the balances of certain funds and accounts which are commingled with the General Fund for investment may not be drawn down to meet General Fund cash expenditure needs in FY 87. Should the budget reserve fund or the railbelt energy fund be appropriated for other purposes or should the attorney general opine that certain of the commingled funds and accounts may be drawn down for General Fund expenditures in FY 87, the FY 88 estimate for investment earnings would be significantly reduced. Estimates for investment earnings for FY 88 and FY 89 do assume that moneys from these accounts and funds will be appropriated and spent in those years.

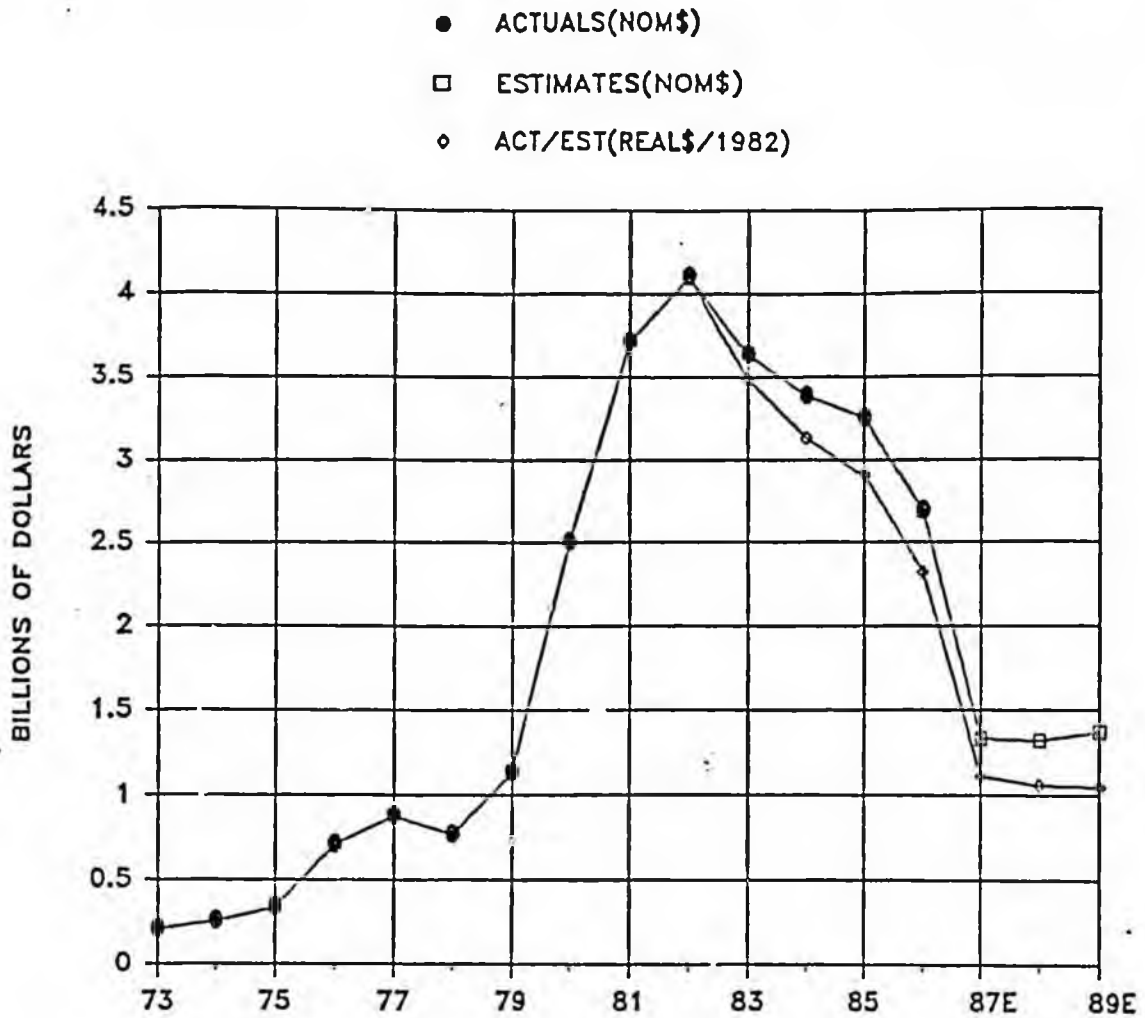
(12) Estimates reflect increased construction of roads and drilling pads as projected by the Department of Natural Resources; however, some of these projects may be delayed or changed due to permit denials or environmental impact statement requests.

(13) The State, per AS 38.05.180, will be granting incentive credits against royalties, severance taxes, and rentals to the oil companies for drilling exploratory wells. The deduction is approximately \$0.7 million which has not been subtracted from the aforementioned FY 86 figure of \$2,682.7 million and approximately \$2.9 million which has not been subtracted from the aforementioned FY 87 figure of \$1,334.2 million. Additional credits are anticipated in subsequent years.

(14) The FY 86 figure does not include the \$243 million the State received from the ARCO settlement on January 15, 1986.

(15) The FY 86 and FY 87 figures do not include the estimated General Fund portion from refunds and expenses for prior years, relative to the TAPS case. The State received \$149.8 million during FY 86 but this figure is subject to audit. Approximately \$65.0 million is projected to be received during FY 87. This figure is also subject to future audits.

FIGURE 2  
**GENERAL FUND UNRESTRICTED REVENUES**  
 (NOMINAL DOLLARS VS. REAL DOLLARS)



**Revenue Actuals**  
(Nominal \$)

FY 73	208.2 million
FY 74	254.9 million
FY 75	333.4 million
FY 76	709.8 million
FY 77	874.3 million
FY 78	764.9 million
FY 79	1,133.0 million
FY 80	2,501.2 million
FY 81	3,718.2 million
FY 82	4,108.4 million
FY 83	3,631.0 million
FY 84	3,390.1 million
FY 85	3,260.0 million
FY 86	2,682.7 million

**Revenue Estimates**  
(Nominal \$)

FY 87	1,334.2 million
FY 88	1,325.0 million
FY 89	1,373.9 million

**Revenue Actuals/Estimates**  
(Real \$/1982)

FY 82	4,108.4 million
FY 83	3,482.6 million
FY 84	3,134.7 million
FY 85	2,900.2 million
FY 86	2,323.2 million
FY 87	1,112.4 million
FY 88	1,056.5 million
FY 89	1,047.5 million

IT SHOULD BE NOTED THAT THE ABOVE AMOUNTS DO NOT INCLUDE ANY SPECIAL SETTLEMENTS. THE FY 86 BOTTOM LINE WOULD INCLUDE AN ADDITIONAL \$243.0 MILLION (ARCO SETTLEMENT) AND \$149.8 MILLION (TAPS REFUNDS/LEGAL EXPENSES). FOR FY 87, THE ABOVE FIGURES WOULD INCLUDE AN ADDITIONAL \$65.0 MILLION (TAPS REFUNDS/LEGAL EXPENSES).

TABLE II

Key Assumptions for January 1987  
 Petroleum Revenue Projections  
 For FY 1987 - FY 1989

<u>Fiscal Year</u>	<u>(\$/bbl) Mean Wellhead Value</u>	<u>(\$/bbl) 30% Wellhead Value</u>	<u>Mean TAPS Throughput (MMbbs/day)</u>	<u>Mean Rate Inflation %</u>
1987	\$5.51	\$4.74	1.81	3.89
1988	\$8.61	\$6.68	1.73	4.58
1989	\$10.59	\$8.03	1.66	4.58

Sales Price for  
Alaska North Slope Crude Oil at Los Angeles, California

	<u>Weighted Average</u>	<u>30% Case</u>	
FY 87	\$11.18	\$10.41	per barrel
FY 88	\$13.57	\$11.64	per barrel
FY 89	\$14.89	\$12.33	per barrel

Sales Price for  
Alaska North Slope Crude Oil at Houston, Texas

	<u>Weighted Average</u>	<u>30% Case</u>	
FY 87	\$12.59	\$11.82	per barrel
FY 88	\$14.97	\$13.04	per barrel
FY 89	\$16.39	\$13.83	per barrel

Weighted Average TAPS Tariff

FY 87	\$4.25	per barrel
FY 88	\$3.76	per barrel
FY 89	\$3.44	per barrel

# Alaska State Legislature

REPRESENTATIVE  
MARK BOYER

HOUSE FINANCE COMMITTEE



House of Representatives

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ELF REPEAL, NOT PERMANENT OR RAILBELT FUNDS, SHOULD FUND RECOVERY

I recently answered a "question of the week" in the other local newspaper, which asked if I supported the Governor's proposed education endowment, by stating that I didn't think we should tap the Permanent Fund earnings for a basic need such as education after we had just given the oil industry a \$150 million tax break through our failure to act on the Economic Limit Factor. A letter to the editor of that newspaper the next week questioned the soundness of my judgement in making such a statement days after ARCO announced that it was planning to spend \$300 million on North Slope construction. The writer of that letter made an assumption which is not supported by fact or recent experience: that Fairbanks will benefit in any meaningful way from that proposed activity on the Slope this season. 1986 saw the largest sealift in North Slope history, but if you looked around Fairbanks and talked to local businessmen and construction workers, as I did during five months of campaigning that year, you never would have guessed it.

We in Fairbanks have come to have much in common with the residents of Southeast Alaska, who maintain that the only benefits which they derive from oil development are those which are

provided by the state government and funded by oil taxes. Since the expiration of the Project Labor Agreements, which mandated dispatch of workers from Fairbanks hiring halls, in December of 1985, the number of Fairbanksans going to work on the Slope has dropped precipitously, even during periods of major construction activity. Those Alaskan residents who are fortunate enough to secure employment on the Slope, which continues to be a haven for out-of-state workers, are hired out of Anchorage and Kenai.

Fairbanks businesses have, with few exceptions, fared no better than our local construction workers in obtaining North Slope work. While the prospect of a few million dollars worth of mini-module construction is dangled before our local firms (and eventually awarded to in Mat-Su and Anchorage) hundreds of millions of dollars is spent on Outside module fabrication. I guess they figure that the same workers who are installing the "maxi" modules up North might as well build them, back home in Louisiana.

I might feel differently about an undeserved and inappropriate tax break for the Prudhoe Bay operators if I saw some indication that their activities are going to directly benefit workers and businesses in Fairbanks. That is clearly not the case, however, and I am more concerned with providing important government services to Fairbanks and the rest of Alaska without raiding the Permanent Fund or the Railbelt Energy Fund than I am with protecting the oil companies' bottom line. New

figures just released by the Department of Revenue show that repeal or suspension of the Economic Limit Factor for the Prudhoe Bay oilfields would have added \$187.4 million to state revenues in FY 88 and \$227.6 million in the fiscal year for which we are currently budgeting, FY 89. Given the choice of using Permanent Fund earnings or Railbelt funds to fund worthwhile programs which will push our FY 89 budget beyond expected revenues or repealing the ELF, the choice is clear.

Here are just a few of the budget items which fall into the "great idea, but how are you going to fund it?" category, and which we might fund with an additional \$227 million in the FY 89 budget:

\$20 million to implement the Governor's recommendations from his Interim Children's Commission for intervention and prevention services for children at risk of sexual and physical abuse, neglect, domestic violence, suicide, and substance abuse.

\$30 million to increase Municipal Assistance and Revenue Sharing to FY 87 levels to help local governments adjust to their changed financial condition without undue burden on local taxpayers already struggling to make ends meet.

\$75 million for an additional capital budget, to include

funds for continued progress on University construction projects underway statewide, including the Butrovich Building and the TVCC Downtown Center, and to begin construction of the Natural Sciences Facility at UAF.

\$4 million for increased faculty compensation at the University of Alaska, to retain and recruit high quality faculty.

\$40 million for other economic development or recovery projects, which might include: mortgage relief for AHFC homeowners; increases in the operating budget for programs which can facilitate private sector development, such as DNR, DEC, and Fish and Game; economic development grants through DCED.

\$3 million for inspection of school buildings for asbestos and development of management plans as required by federal law.

\$5 million to continue to meet our commitment to mental health as a result of last year's mental health lands settlement.

\$3 million to hospitals to help offset their catastrophic illness problem, which this year exceeds \$15 million statewide.

\$1.5 million to bring services for the developmentally disabled back to FY 86 levels.

\$46 million for deposit in the budget reserve.

Of course, this is only one possible scenario for using an additional \$227 million in state revenues this year, but it gives an idea of the positive impact that such an infusion could have on our economy, without raiding the permanent or Railbelt funds.

The allegedly "marginal" Prudhoe Bay oilfields out-produce most others in the world at a fraction of the average worldwide per barrel production cost, yet the Senate let the ELF take effect last June, when it was estimated that the tax break (the repeal of which was decried as a tax increase by Senators) would cost the state \$80 million in FY 88. Increases in the price of oil, in throughput of the TAPS line, and in drilling activity have all served to amplify the effect of the ELF beyond that initial estimate to the \$187.4 million figure cited earlier.

A primary reason for the dramatic increases in lost revenues is the fact that the tax break allowed by the Economic Limit Factor is based on production per well. The Prudhoe Bay operators have embarked on a major drilling program, funded by the ELF, to increase the number of wells, so that peak production is maintained, but at a lower number of barrels per well. The incentive to drill more wells to come under the ELF is like paying

farmers not to plant their crops. This has served to maximize the ELF giveaway beyond the expectations of anyone studying the issue last year. The revenue loss from ELF for FY 89 was expected to be \$100 million. A Department of Revenue report released earlier this week projects a loss of \$227 million for that year, and further losses of \$280 million, \$272 million, \$248 million, and \$216 million for the four succeeding fiscal years (a total of \$1.4 billion, FY 88 - FY 93). Commissioner of Revenue Hugh Malone has aptly described this policy as "self-inflicted poverty."

The most ironic aspect of this situation is the fact that the formula for calculating the Economic Limit Factor which is contained in HB 164 is more favorable to truly marginal oil fields than the current formula. There was an audible thud in the House Finance Committee hearing on HB 164 last session as oil company lobbyists' jaws dropped when they heard the representative of Conoco, whose company operated the one truly marginal field on the North Slope until the price drop forced its closure, testify in support of HB 164. The Conoco representative stated that under the new ELF formula the Milne Point fields mothballed by Conoco would come back on line much sooner than under the present formula. If there had been any doubt that the resistance to ELF repeal was motivated more by a desire to give Big Oil a hefty tax cut than a fear of providing a disincentive to development of marginal fields, this testimony alone should have dispelled it. HB 164 passed the House on a vote of 25 - 15 last April. It has languished in the Senate State Affairs Committee ever since.

STATE OF ALASKA  
1988 LEGISLATIVE SESSION

BILL VERSION: CSHB 164(Fin) am  
PUBLISH DATE: \_\_\_\_\_

FISCAL NOTE

REQUEST:

Revision Date: March 4, 1988 Agency Affected: \_\_\_\_\_  
Title: An Act Relating to the Oil and Gas Properties Production Tax and Effective Date BRU: \_\_\_\_\_  
Sponsor: Rules/Governor Components: \_\_\_\_\_  
Requestor: \_\_\_\_\_

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 88	FY 89	FY 90	FY 91	FY 92	FY 93
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING						
CAPITAL						

REVENUE	187,410	227,630	280,260	272,570	248,510	216,540
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FUNDING: (Thousands of Dollars)

*\$ 1,432,920,000 in 6 yrs.*

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL						

*Last if ELF is not modified by passage of this bill*

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS : (Attach a separate page if necessary)

(See Attached)

Prepared by: Charles L. Logsdon Phone: 277-5627  
Division: Oil and Gas Audit Date: March 4, 1988

Approved by Commissioner: Hugh Malone W.F.R. Date: 3/8/88  
Agency: Revenue

Distributor (by preparer):

- Legislative Finance
- Legislative Sponsor
- Requestor
- Office of Management and Budget
- Impacted Agency(ies)

This bill would effectively increase the severance tax rate on fields producing greater than approximately 120,000 barrels per day. At the same time fields producing less than this amount would be taxed at a lower rate. The relative increase or decrease would depend on the relative per well productivity of the field. The estimates contained in this fiscal note are based on the Department of Revenue March 1988 average assumptions about production and wells and the September 1988 average expected oil price.

The following tables illustrate both the revenue and tax rate impact of the bill by North Slope oil field.

Revenue Impact by North Slope Oil Field  
(Millions Dollars)

Fiscal Year	Pruchoe	Koparuk	Milne	Indicott	Lisburne	West Sak	Thonson	Seal	Niakuk	North Slope
1988	<del>224</del> 133.57	<del>57</del> 59.56	0	0	-6.02	0	0	0	0	<del>224</del> 137.41
1989	161.97	72.11	0	0	-6.45	0	0	0	0	227.63
1990	291.23	88.54	0	-2.48	-7.13	0	0	0	0	280.26
1991	235.52	50.55	0	-2.54	-5.3	0	0	0	-5.16	272.57
1992	237.23	51.09	-11.73	-2.85	-8.98	0	-5.45	0	-9.8	248.51
1993	230	50.53	-29.72	-6.9	-8.37	0	-8.33	0	-10.72	216.54
1994	220.71	49.15	-30.2	-9.14	-9.22	0	-9.15	0	-12.27	199.88
1995	215.03	41.79	-33.15	-10.49	-10.02	0	-10.02	0	-7.92	185.22
1996	204.76	30.67	-33.88	-10.82	-11.1	0	-11	0	-8.63	159.95
1997	201.93	19.69	-34.84	-10.67	-11.72	0	-14.73	0	-8.11	141.55
1998	213.57	9.89	-35.72	-1.19	-12.35	0	-15.03	-12.39	-8.22	134.51
1999	210.3	3.28	-32.94	-6.64	-12.49	0	-17.3	-10.86	-9.69	124.26
2000	230.27	1.52	-36.84	-3.54	-12.91	0	-18.56	-5.78	-10.45	143.71
2001	232.3	.53	-32.73	-1.01	-14.48	0	-17.3	-6.3	-8.77	152.69
2002	235.74	-.02	0	-.02	-15.66	0	-17.47	-5.72	-6.38	129.47
2003	339.18	-.09	0	-.03	-15.52	0	-14.75	-8.86	-25.03	274.9
2004	353.23	-.08	0	0	-15.54	0	-10.36	-9.31	-20.3	302.54
2005	347.35	-.03	0	0	-15.43	0	-6.53	-9.79	-18.94	295.47
Total Revenue										
Fiscal	4210.92	534.93	-311.85	-63.42	-200.23	0	-173.09	-70.01	0	3917.1
101	1753.01	350.56	-125.17	-31.41	-78.62	0	-60.13	-18.23	0	1796.06
81	2041.51	378.38	-148.47	-35.32	-92.45	0	-73.46	-23.57	0	2045.62

Change in tax rate

Year	Pradhoe	Kuparuk	Milne	Endicott	Lisburne	West Sak	Thomson	Seal	Hiakuk
1988	.02487	.071445	0	0	-.03159275	0	0	0	0
1989	.02487	.071445	0	-.00346675	-.03198475	0	0	0	0
1990	.02487	.071445	0	-.001558	-.0276605	0	0	0	-.07216475
1991	.02487	.071445	0	-.00150675	-.02719275	0	0	0	-.0073915
1992	.02487	.071445	0	-.00885575	-.0230055	0	0	0	-.00975575
1993	.02487	.071445	0	-.018285	-.02766	0	-.0320215	0	-.0078325
1994	.02487	.071445	0	-.013235	-.02766	0	-.03193575	0	-.001483
1995	.02487	.071445	0	-.013235	-.02766	0	-.0318255	0	-.00736
1996	.02487	.071445	0	-.013235	-.02766	0	-.0317275	0	-.009505
1997	.02487	.071445	0	-.013285	-.02766	0	-.03095575	0	-.009555
1998	.02487	.071445	0	-.013285	-.02766	0	-.03717	0	-.009205
1999	.02487	.071445	0	-.013235	-.02766	0	-.050835	-.002009	-.00976
2000	.02487	.071445	0	-.013235	-.02766	0	-.059235	-.0023275	-.000225
2001	.02487	.071445	0	-.018285	-.02766	0	-.06369	-.00231525	.00063
2002	.02487	.071445	0	-.013235	-.02766	0	-.067425	-.00231525	0
2003	.02487	.071445	0	-.013235	-.02766	0	-.060735	-.00197225	0
2004	.02487	.071445	0	-.013285	-.02766	0	-.049425	-.002085	0
2005	.02487	.071445	0	-.013235	-.02766	0	0	0	0

# Alaska State Legislature

S  
Senator Mitch Abood  
CHAIRMAN

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ANCHORAGE, ALASKA 99503  
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IN SESSION:  
POUCH V  
JUNEAU, ALASKA 99811  
(907) 465-4714



## Senate Committee on State Affairs

March 10, 1988

The Honorable Steve Cowper  
Alaska State Capital  
P. O. Box A  
Juneau, Alaska 99811

Dear Governor Cowper,

Thank you for your letter of March 2, 1988 requesting an early hearing on CSHB 164, the so-called ELF bill. Your letter states that "new information has become available suggesting that the ELF factor is creating an incentive for operators to drill additional wells" which in turn is leading to larger than expected revenue "losses." Responding to your letter I would encourage you to consider the following:

1. ELF is working just as intended. That is, it is providing an incentive for producers to follow full and optimal development programs at Prudhoe Bay and to delay the onset of field decline. The decline at Prudhoe has been pushed back to mid-1989. In fact, absent the extensive drilling and workover program in progress today, the decline would have been far greater than any revenue that might be "lost" because these wells are being drilled.
2. In the next two years the state will likely receive an additional \$524 million in royalty and severance tax revenue over the June 1987 forecast by the Department of Revenue. Although oil prices have risen since this forecast, I believe the ELF relief that some are now complaining about, can be fairly viewed as an investment that is generating a return of better than 70 percent directly to the state. It seems like a pretty good investment.
3. The cost of the industry's current drilling program on the North Slope is estimated at over \$400 million. No

Governor Steve Cowper  
Page 2  
March 10, 1988

prudent businessman would spend \$400 million simply to reduce severance tax by \$30 million per year, which is the average impact for 1987 and 1988 fiscal years, according to Charles Logsdon's February 19th memorandum to Commissioner Malone.

4. The bulk of the current \$400 million drilling program is being spent in Alaska. Each of the eight rigs at Prudhoe, Kuparuk, and Endicott directly employs over 100 Alaskans, with over 200 more indirect jobs in support industries. This total computes to over 2400 full-time jobs, and is even greater than the number of jobs that we hope will be created under the \$75 million "jobs bill."
5. In the past 16 months, the oil industry has brought on line major investments in the Lisburne and Endicott fields and in the central gas facility at Prudhoe Bay, despite the gyrations in oil prices. The collective capital costs for these investments is over \$3 billion. As a result, production of oil (and gas liquids) has risen by more than 210,000 barrels a day, and the additional reserves to be recovered have increased by more than one billion barrels. The confidence of the industry to continue to make these investments during a period of price instability will be due in major part to its perception of a stable tax environment in Alaska.
6. With regard to the development of small and marginal fields, I would remind you of AS 43.55.013(d). This statute is specifically designed to provide additional aid to marginal fields by rebutting the 300 barrel/day presumptions. Reasonable application of this section by the Department of Revenue should provide appropriate severance tax relief for the small and marginal fields you were referring to. As you know, Conico, for their Milne Point Field, unsuccessfully attempted to utilize this statute.

Alaska has become the number one oil-producing state as a result of continued investment by the oil companies in Alaska, as investments in the lower 48 shrank. Since 1981, our stable tax environment has been a key to encouraging investment in Alaska and will continue to encourage investment in the future. I am committed to keeping that stable tax environment in the face of opposition of those interested only in squeezing more money to spend on Government, out of the oil companies who should be treated as partners.

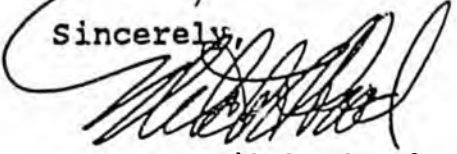
Governor Steve Cowper

Page 3

March 10, 1988

It is for these reasons that CSHB 164 dated 4-15-87 will remain in the Senate State Affairs Committee.

Sincerely,



Senator Mitch Abood,  
Chairman

MA/kd

cc: Senate President Jan Faiks  
Speaker of the House Ben Grussendorf  
Commissioner Hugh Malone, Department of Revenue

## ELF BULLETS

- As originally enacted in 1978, ELF was intended to give producers a break on severance taxes on low-production wells such as those in Cook Inlet. When Republicans took control of the House in the 1981 coup, they adopted the Senate Republicans' rewrite of the ELF law, which had the effect of allowing the tax break to be applied to Prudhoe Bay starting in 1987, well in advance of the "supergiant" field beginning its production decline.
- The House last year passed and sent to the Senate new legislation that would close the loophole allowing high-production fields to reap the tax-avoidance benefits of the ELF law. If the Senate does not approve the House bill, the State of Alaska will lose an estimated \$415 million over this fiscal year and the next, according to the Department of Revenue. The five-year loss, through FY 92, is estimated to total \$1.2 billion.
- The oil companies argue that changing the ELF now could cause them to cut some of the 2,400 jobs they claim the tax break has allowed them to bring to their North Slope operations, and they'd prefer the Legislature cut the state budget by \$400 million to cover the ELF loss. We know that nowhere near 2,400 North Slope jobs have been created, but even if that number were true, it's hardly likely the Alaska economy would receive the full benefit of those jobs, given the industry's history of hiring out-of-state residents to work on the Slope. Even more significantly, if we were to follow the industry's advice and cut another \$400 million from the state budget, the economy would lose more than 9,500 jobs -- jobs now held by Alaskans, not temporary workers who send their paychecks home to other states.
- The oil companies also argue that changing the ELF law to avoid the anticipated loss would disrupt their "stable tax climate." The implication that changing the ELF would represent an unfair tax burden on the industry or would somehow jeopardize profits simply is not supportable. The fact is the industry long ago recovered the initial capital costs from North Slope operations; after deducting all taxes, operating costs and even new investment costs, the companies as of 1986 had all managed to take approximately \$18.6 billion in net profits out of Alaska.



ALASKA STATE LEGISLATURE  
HOUSE OF REPRESENTATIVES  
RESEARCH AGENCY

P.O. Box Y, State Capitol  
Juneau, Alaska 99811-3100  
Mail Stop 3100  
(907) 465-3991

April 27, 1988

MEMORANDUM

TO: Representative Sam Cotten

FROM: Brad Pierce *BP*  
Legislative Analyst

RE: Oil Industry Facts  
Research Request 88.236

You requested this agency to provide some basic economic and financial facts about oil industry operations in Alaska and the profitability of the petroleum transportation network between the North Slope and the Gulf Coast of the United States. Specifically, you asked:

- Has the number of jobs on drilling rigs on the North Slope increased since the Economic Limit Factor (ELF) was applied to Prudhoe Bay and Kuparuk production?
- How much revenue and profit do oil companies make from the Trans-Alaska Pipeline System (TAPS)?
- How much revenue and profit do oil companies make from their tanker operations?
- How much revenue and profit do oil companies make from the Panama pipeline?
- Compare petroleum taxes and royalties charged by the State of Alaska with those charged by other oil producing states.
- Discuss the terms of the TAPS tariff settlement and their effect on the state's revenues.

We address your questions in separate sections of this memorandum. Much of the information we have gathered comes from previous House Research memorandums, a recent Office of Management and Budget report--"The ELF: A Policy Perspective," and various issues of Petroleum Intelligence Weekly.

### Pre- and Post-ELF North Slope Oilfield Employment

The ELF is a tax reduction calculation that is applied to the state severance tax rate on the basis of average daily per-well productivity in a given oilfield. When enacted as part of a larger overhaul of the state's oil taxation package in 1981, the ELF was designed to encourage development of marginal fields. The Prudhoe Bay and Kuparuk fields, which are the largest and most profitable in North America, were specifically exempted from the ELF for the first ten years following commercial production. In June 1987, the moratorium on applying the ELF to the Prudhoe Bay and Kuparuk fields ended. The state revenue loss of applying the ELF to these fields in FY 88 is about \$150 million. A new formula for calculating the ELF is incorporated into legislation (CSHB 164) which has passed the House. This revised formula would reduce the severance tax reduction provided to the Prudhoe Bay and Kuparuk fields and increase the reduction to smaller fields.

Proponents of applying the original ELF to Prudhoe Bay and Kuparuk claim that by providing an incentive to drill more production wells, it will increase oil field employment, and that the economic effects of this private sector investment will offset any revenue loss to the state. Opponents say the ELF has very little to do with incentives to drill additional production wells in highly profitable fields. They argue that the key variable in an oil company's decision to drill additional wells is the expected price of crude oil and whether the marginal productivity of an additional well can be expected to justify the investment. They note that the difference in severance tax per barrel between the original and revised ELF formula is \$0.21 at Prudhoe Bay and \$0.42 at Kuparuk on a commodity that has varied in price by as much as \$20 per barrel during the past ten years of profitable North Slope operations.<sup>1</sup>

*NR  
North  
Slope*

The Department of Labor (DOL) maintains statistics on the number of oilfield jobs on the North Slope, which are compiled quarterly. There is a two quarter lag in the availability of employment information, so the only comparable pre- and post-ELF North Slope oil and gas industry employment data currently available are for the third quarters of 1986 and 1987. Average monthly oil and gas employment on the North Slope during the third quarter 1986 was 2,416. During the third quarter 1987, average employment

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<sup>1</sup>"March 1988 Revenue Forecast," Alaska Department of Revenue, March 23, 1988.

was 3,095. Thus, average oil and gas industry employment grew by 679 or 22 percent. Note that this is a very limited database from which to draw conclusions. Note also that according to the Department of Natural Resources, Division of Oil and Gas, the weighted average wellhead price of oil in September 1986 was \$5.06 per barrel for Kuparuk and \$4.85 at Prudhoe Bay. In September 1987, the wellhead prices were \$10.84 and \$11.84 respectively.

The DOL has also gathered occupational profile data on oilfield employment, i.e., the number of drillers, service workers, etc., from surveys of employers since late 1986 (a detailed list of drilling company occupations and employment is provided in Attachment A). Thus, we can offer a limited comparison of pre- and post-ELF oilfield drilling company employment on the North Slope. The DOL estimates there were 548 drilling workers employed on the North Slope during the fourth quarter of 1986 compared with 501 in the fourth quarter of 1987 (the only two quarters for which data are available). Thus, according to DOL data, drilling employment has actually declined by about nine percent since the ELF went into effect for the Prudhoe Bay and Kuparuk fields. Again, this is a very small number of observations from which to draw conclusions.

There is little doubt that the 7 to 14 percent anticipated reduction in state revenues from imposition of the original ELF on Prudhoe Bay and Kuparuk will have far-reaching fiscal consequences on future state government operations.<sup>2</sup> From an ideological standpoint, reducing government spending and encouraging private sector earnings and investment may be desirable. From a purely economic perspective, however, state spending of these foregone revenues would have a significantly larger economic impact in Alaska than ELF-induced oil company investments at Prudhoe Bay and Kuparuk.

Proponents of the existing ELF formula claim that it has produced 800 direct drilling jobs and 1,600 additional indirect and induced jobs in support services and other sectors of the economy. Note that the DOL employment figures cited above do not support this assertion, at least in terms of direct employment. According to the DOL, the oil and gas industry

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<sup>2</sup>The oil companies say the application of the ELF to Prudhoe Bay and Kuparuk will result in a 7 percent reduction in state revenues, while the Office of Management and Budget (OMB) calculates the reduction at 8 to 14 percent.

in Alaska ranks first in the total amount of wages paid to nonresident employees and fourth among industries with the largest number of nonresident employees.<sup>3</sup> Approximately 21 percent of oil and gas industry employees in 1986 were nonresidents. As the OMB has shown in their ELF analysis, only about 18 percent of oil companys' cash flow from North Slope operations is reinvested in Alaska.<sup>4</sup> The rest leaks out of the state economy.

As an example of the disparity between the economic impact of state revenues vs. ELF-induced investment, consider that \$150 million in revenues applied to the personal services category of the state operating budget could fund about 3,000 direct state jobs, while oil company expenditure of \$150 million has resulted in 800 direct jobs (claimed by the oil companies) but no additional drilling jobs verified by the DOL. Virtually all State employees would be residents who would spend their wages within Alaska, in turn producing indirect and induced benefits to the economy.<sup>5</sup>

#### Revenue and Profit from the TAPS

Eight pipeline companies (all of which are subsidiaries of major oil companies) own the TAPS: Amerada Hess Pipeline Corp., Arco Pipelines Co., BP Pipelines, Inc., Mobil Alaska Pipeline Co., Phillips Alaska Pipeline Corp., Sohio Pipeline Co., and Union Alaska Pipeline Co. Alyeska Pipeline Service Company operates the TAPS for the owners. Roughly 94 percent of Alaska oil production is shipped via the TAPS.<sup>6</sup>

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<sup>3</sup>"Nonresidents Working in Alaska in 1986," Alaska Department of Labor, January 1988, p. 10.

<sup>4</sup>"The ELF: A Policy Perspective," pp. 13, 18.

<sup>5</sup>According to the "Statistical Quarterly," (various issues) published by the DOL, the average state employee wage in FY 87 was \$34,602 plus \$7,779 in benefits and 3,720 in insurance (\$46,100 total compensation package).

<sup>6</sup>House Research Memorandum 87.132, March 6, 1987.

Each pipeline company charges a separate tariff, which on a consolidated basis currently averages \$3.20/bbl. of throughput according to the Petroleum Intelligence Weekly (PIW).<sup>7</sup> At an average daily throughput of approximately 2 million barrels, the TAPS owners presently receive revenues of about \$6.2 million per day or \$2.26 billion per year. The PIW estimates pipeline profits at \$0.43/bbl. or \$860,000 per day (\$314 million per year). Using information supplied by the Alaska Public Utilities Commission (APUC), we estimate that pipeline operation between 1977 and 1986 (the most recent year for which data are available), produced \$30.35 billion in gross operating revenues on total throughput of 5.12 billion barrels. According to the APUC, the pipeline owners have spent about \$26.9 billion to build, operate and maintain the TAPS through 1986.<sup>8</sup> On a cumulative basis, TAPS gross operating revenues appear to have first exceeded estimated expenses in 1984.<sup>9</sup>

#### Revenue and Profits from Tanker Operations

Approximately 40 percent of domestic tanker tonnage in the Alaska trade is owned by oil companies; the remainder is chartered.<sup>10</sup> Among the oil companies, there is a wide variance in the amount of proprietary tonnage versus chartered tonnage. Standard Oil for example, must charter its entire tanker requirements because it is controlled by a foreign company (British Petroleum), which cannot own U.S. flag tonnage under provisions of the Jones Act. According to the PIW, the average shipping cost via tanker from Valdez to the West Coast (Puget Sound, San Francisco and Los Angeles) is \$0.99/bbl. and to the Gulf Coast (including an \$0.80/bbl. Panama Pipeline tariff) is \$3.35/bbl.

In its netback calculations of oil company revenues for severance and income tax purposes, Department of Revenue (DOR) allows oil companies to charge a tanker transport tariff equal to operating expenses plus a profit margin of two percent over inflation. This translates into a current profit margin of approximately six percent.<sup>11</sup> Thus, if we assume a TAPS throughput of two million barrels per day, with 60 percent going to the West Coast and 40 percent to the Gulf Coast, oil companies have estimated total revenues of \$3.23 million per day (\$1.18 billion per year) and profits of about \$193,200 per day (\$70.52 million per year) from their tanker operations.

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<sup>7</sup>February 1, 1988, p. 2.

<sup>8</sup>"Eighteenth Annual Report to the Legislature," Alaska Public Utilities Commission, February 15, 1988, p. 86.

<sup>9</sup>House Research Agency Memorandum 87.132.

<sup>10</sup>"Report to Congress on Alaskan Oil," U.S. Department of Commerce, June 1986, p. II-26.

<sup>11</sup>Roger Marks, DOR Economist, personal communication, April 1988.

### Panama Pipeline Revenues and Profits

The Trans-Isthmian oil pipeline across Panama began operation in October 1982. The pipeline has an average maximum capacity of 800,000 barrels per day and is a joint public-private venture with the Government of Panama (through Cofina, the National Finance Corporation) at 40 percent equity; Northville Terminal Corporation (U.S.) at 38.75 percent equity and Chicago Bridge and Iron Industries (U.S.) at 21.25 percent equity.<sup>12</sup> The original investment amounted to \$347.7 million, which was apparently paid off by mid-1986. The Panamanian government estimates that the pipeline has a total domestic economic impact of 700 jobs and \$150 million in gross revenues per year.

Using the \$0.80/bbl. tariff charge cited previously and assuming 800,000 barrel per day throughput, the pipeline generates an estimated \$233.6 million in gross annual revenues for the owners. We do not have figures on annual operating costs and thus have no means to calculate pipeline profits.

### Comparison of Petroleum Taxes and Royalties

Comparing effective petroleum tax rates among states is not a straightforward exercise, as they rely on different tax instruments to generate revenues. For example, Texas has a lower severance tax rate than Alaska but charges a much higher royalty. Table 1 provides a summary of the taxing strategies of the top five oil and gas producing states. A more complete description of the taxing instruments used by these states is included in Attachment B.

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<sup>12</sup>"Report to Congress on Alaskan Oil," p. IV-59.

TABLE 1

STATE TAXES AND ROYALTIES IMPOSED ON OIL & GAS PRODUCTION  
IN THE TOP FIVE PRODUCING STATES

STATE	PROPERTY TAX	PRODUCTION TAX	OTHER TAX	ROYALTY	CORPORATE INCOME TAX
ALASKA	placed upon oil and gas production and pipeline transportation property--20 mills of full and true value	Oil: 15% of gross value or \$0.80 per barrel, whichever is greater, multiplied by the economic limit factor. Gas: 10% of gross value or \$0.064 per MCF, whichever is greater, multiplied by economic limit factor	Conservation tax: \$.00125 per bbl.	12.5%	sliding scale--over \$90,000 @ 9.4%
CALIFORNIA	rates fixed locally	production charge--rate determined annually	Documentary Transfer Tax: transfer of deeds, 55 cents per \$500 of value	30%	9.6% of net income derived within the State
LOUISIANA	none	Oil: 12.5% of value Gas: 7 cents per MCF	Natural gas pipeline companies franchise tax: based on gross receipts apportioned to state, 1%	20%-25%	sliding scale--over \$200,000 @ 8%
OKLAHOMA	none	Oil and Gas: 7% of gross value	Oil excise: .085 of 1% of gross value per barrel produced. Gas excise: .085 of 1% gross value of gas produced Natural and casinghead gas conservation tax: 7 cents per MCF less 7% of the gross value of each MCF	18.75%	5% of federal income tax
TEXAS	aggregate of local rates	Oil: 4.6 cents per bbl. (not less than 4.0% of market value) plus 3/16 of 1 cent per bbl. Natural Gas: 7.5%. Minimum, 121/1500 of 1 cent per MCF	none	20%-25%	Franchise tax--\$5.25 per \$1,000 stated capital, surplus, and undivided profits allocated according to gross receipts from intrastate business

The table below compares Alaska's severance tax rates for production from Prudhoe Bay and Kuparuk under the present and proposed ELF formulae with those of four other oil producing states:

State	Severance Tax Percent of Value	Severance Tax Per Barrel
Wyoming	13.0 percent	\$2.02
Louisiana	12.5	1.94
Oklahoma	7.0	1.08
Texas	4.6	0.71
Alaska (Prudhoe Bay proposed)	14.8	1.26
Alaska (Prudhoe Bay existing)	12.3	1.05
Alaska (Kuparuk proposed)	11.9	1.04
Alaska (Kuparuk existing)	8.0	0.62

Source: "The ELF: A Policy Perspective," pp. 21, 22.

\* \* \*

It is important to look at the severance tax on both a percentage and a per barrel basis. Since production from the North Slope occurs on a vastly larger scale and has a much lower wellhead price of oil than some other states with comparable percentage rates, Alaska's severance tax per barrel tends to be lower.

Another important factor to consider when comparing tax rates among various states is their relative dependency on oil and gas revenues. In FY 88, petroleum revenues will account for 84 percent of total Alaska state revenues, while the next largest oil producer, Texas, is only about 20 percent dependent on oil and gas revenues.<sup>13, 14</sup> After the precipitous drop in oil prices in 1986, several of the other oil producing states moved to broaden their tax bases and reduce their dependency on oil and gas revenues. For example, Texas enacted a \$5 billion state sales tax; the largest state tax increase in U.S. history. Alaska has not chosen to broaden its revenue base, which makes state government operations and fiscal management increasingly vulnerable to fluctuations in petroleum revenues.

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<sup>13</sup>"March 1988 Revenue Forecast."

<sup>14</sup>April 27, 1987 Memorandum from Hugh Malone, DOR Commissioner to Governor Cowper regarding Senate President Jan Faiks' Memorandum of April 10, 1987 on Oil and Gas Tax Reductions in Other States, p. 6.

### Terms of the TAPS Tariff Settlement

The TAPS owners filed their original pipeline tariffs with the federal Interstate Commerce Commission (ICC) in mid-1977. The tariffs ranged from \$6.04/bbl to 6.44/bbl, with a weighted average rate of \$6.20/bbl.<sup>15</sup> The State of Alaska, U.S. Department of Justice, Arctic Slope Regional Corporation, and ICC staff immediately filed protests which sought a suspension of the TAPS owners' tariffs and an investigation of their lawfulness. Under the Interstate Commerce Act, the ICC was empowered to determine and prescribe "just and reasonable rates" and correct discriminatory rates.

The state's interest in lower tariff rates was primarily financial; severance tax and royalty revenues are based on wellhead value--market price less costs of transportation to markets. The wellhead value is lower when pipeline tariffs are high. The state had a secondary interest in lower tariffs in order to encourage new oil development on the North Slope, particularly of marginal fields that might otherwise be uneconomical under higher tariffs. Additional crude oil production would increase state tax and royalty revenues.

The U.S. Department of Justice (Antitrust Division) was interested in resolving a longstanding debate on oil pipeline ratemaking methodology. The department also felt that there should be some refund policy or an adjustment of methodology in lieu of refunds. The Arctic Slope Regional Corporation (ASRC) views the TAPS as a crucial component to its aspirations as a future North Slope producer and crude oil shipper. Thus, lower tariff rates are in ASRC's best interest, particularly in the 1990s and beyond.

In the estimation of the Department of Law, the TAPS case was the most costly and complicated litigation in U.S. history. The eleven-year saga of the TAPS case and an outline of the final settlement terms are included in Attachment C. Table 2 shows the additional state revenues collected under the terms of the TAPS settlement through 1988. Figure 1 shows TAPS tariffs under the settlement methodology (TSM) through 1991. This graph depicts one of the state's major objectives in the tariff dispute--to defer revenues into the 1990s and encourage increased oil company investment on the North Slope. This is accomplished by allowing a larger near-term tariff rate, which lowers the state's near-term royalty and severance tax revenues, and a lower tariff rate in the 1990s. The TAPS owners were interested in maximizing near-term income and therefore were amenable to the basic principles of the agreement.

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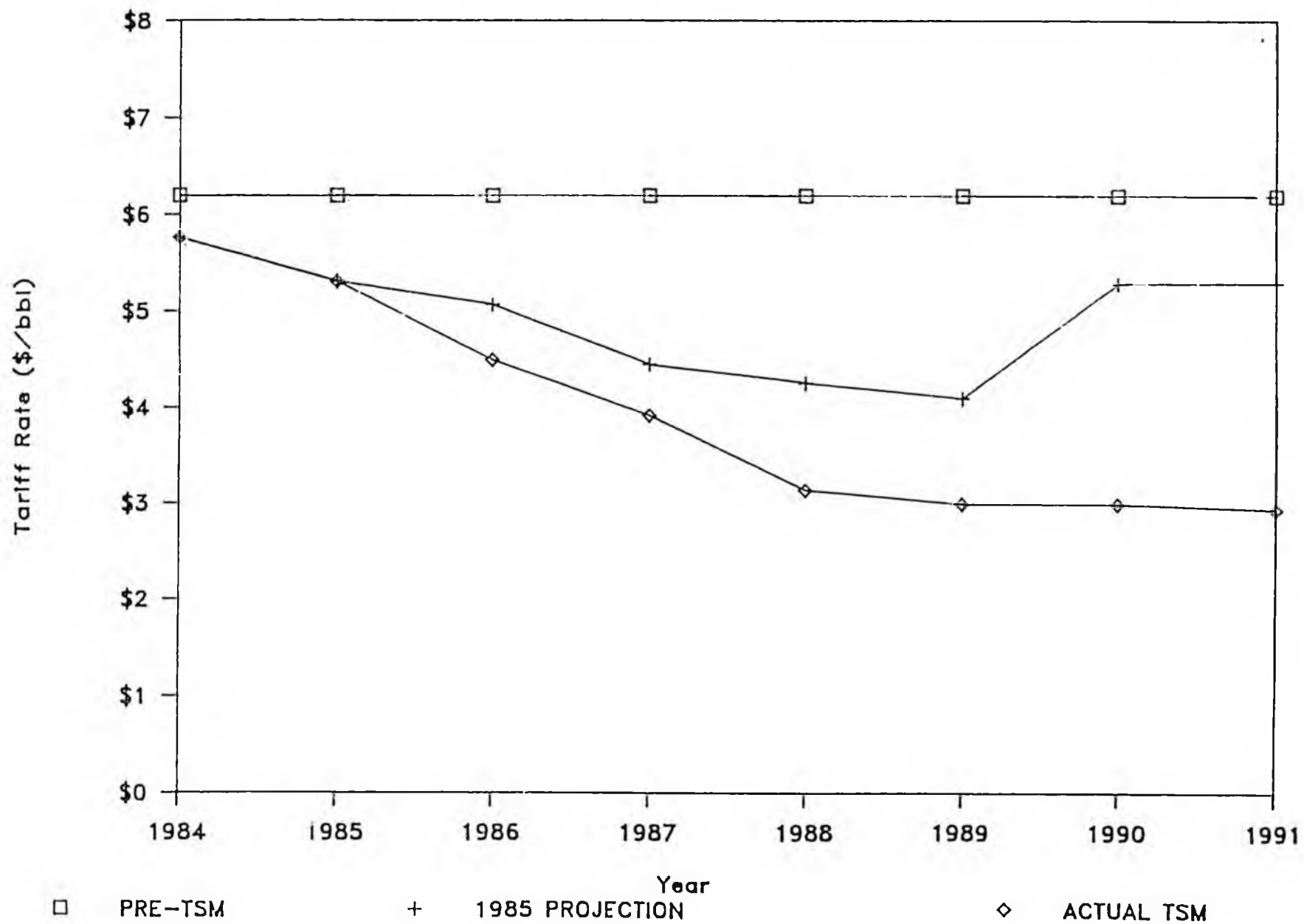
<sup>15</sup>House Research Agency Memorandum 85.175.

TABLE 2  
 ADDITIONAL REVENUES COLLECTED BY  
 THE STATE OF ALASKA  
 UNDER THE TAPS SETTLEMENT AGREEMENT  
 THROUGH 1988  
 (\$ millions)

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	<u>Resulting from Refunds</u>	<u>Resulting from Lower Tariffs</u>	<u>Total</u>
Additional Royalties			
In-kind	\$ 69.59	\$ 384.29	\$ 453.88
In value	<u>38.82</u>	<u>273.55</u>	<u>312.37</u>
Total Royalties	\$108.41	\$ 657.84	\$ 766.25
 Additional Production Taxes	 \$108.77	 \$ 587.96	 \$ 696.73
Reimbursement of Litigation Expenses	<u>33.28</u>	<u>.00</u>	<u>33.28</u>
 TOTAL	 \$250.46	 \$1,245.80	 \$1,496.26

FIGURE 1  
TAPS TARIFFS (1984-1991)



· Representative Cotten  
April 27, 1988  
Page 12

The Department of Law felt that the terms of the TAPS settlement were as good as the state could expect without further litigation, which might be decided against the state. The Department of Law estimates that the settlement will eventually allow the state to realize about 64 percent (\$4.5 billion of \$7 billion in 1985 dollars) of potential contested revenues. The basic tradeoff the state made was in favor of greater revenue certainty against the anticipated delay and expense of further litigation and the risk of an unfavorable outcome in court.

For the oil companies, the terms of the TAPS settlement allowed them to earn an additional \$2.5 billion (1985 dollars) in gross revenues they might not have received under an unfavorable court settlement for the price of their own legal fees plus the \$33 million in litigation expenses they had to reimburse the state.

\* \* \*

I hope we have provided enough information for your purposes. Please call if you have questions.

Attachments

ATTACHMENT A

Oil Drilling Firm Staffing Patterns

# MEMORANDUM

# State of Alaska

TO: Brad Pierce  
House Research Agency

Thru: *JS* Sally Saddler  
Research Supervisor

FROM: Brynn Keith *BK*  
Labor Economist  
AK Dept. of Labor

DATE: April 21, 1988

FILE NO:

TELEPHONE NO: 465-4500

SUBJECT: Oil Drilling Firm  
Staffing Patterns

The attached information reflects the staffing patterns of oil drilling firms operating in the North Slope Borough. Data have been compiled for the fourth quarter of 1986 and the fourth quarter of 1987. These data reflect the same group of oil drilling firms represented in the Governor's ELF report.

Occupational data were taken from reports employers file quarterly with the Alaska Department of Labor.

Occupational information is based on the Standard Occupational Classification structure. This system was designed by the U.S. Department of Commerce and is widely used by both federal and state agencies.

The response rates for drilling firms with North Slope activity are low. North Slope drilling employment is estimated at 548 workers for the fourth quarter of 1986, 325 (59.3%) are represented in the attached. Similarly, an estimated 501 workers were employed on the Slope during the fourth quarter of 1987. Occupational and geographical information was reported for 322 workers for the fourth quarter of 1987, or 64.3% of all drilling workers on the North Slope.

cc: Chuck Caldwell  
Frank Spargo  
Kathy Thomas  
Jeff Hadland

OCCUPATIONAL DISTRIBUTION IN OIL DRILLING FIRMS  
 NORTH SLOPE BOROUGH  
 1986 Q4 & 1987 Q4

OCCUPATION	86Q4 % OF TOTAL	87Q4 % OF TOTAL
Computer Analyst	1.2	0.0
Construction Manager	0.0	0.3
Cook	0.0	4.0
Crane/Tower Operator	1.2	0.0
Drillers, Oil	27.1	24.8
Electrician	4.6	3.1
Excavating/Loading	0.0	1.2
Extract Occs, NEC	25.2	32.3
Heavy Equip Mech	0.6	0.0
Helpers Extractive Occ	2.2	0.0
Helpers Mach Op Assis	0.6	0.0
Indust Mech Rep	4.0	3.7
Indust Truck/Tractor	2.3	0.0
Janitor/Cleaner	0.0	1.6
Mach Maint	1.2	2.3
Managers Food Service	0.0	0.5
Manager Well Drilling	1.5	1.9
Misc Material Moving	5.8	6.2
Mixing Machine Op	4.0	3.7
Separating Mach Op	0.3	0.0
Stationary Eng	1.2	1.9
Supv Extractive Occ	4.3	2.2
Truck Driver Heavy	6.8	3.4
Water/Sewage Plant	0.0	1.2
Welder	4.3	5.0
TOTAL WORKERS	325	322

Source: Alaska Department of Labor, Research & Analysis

ATTACHMENT B

Description of Petroleum Taxing Regimes in the  
Five Top Producing States

## ATTACHMENT B

### Alaska

**Property Tax.** Alaska's principal minerals of commercial significance are exempt from ad valorem property taxes. Although no statewide property tax exists, a tax is imposed upon oil and gas exploration production and pipeline transportation property in lieu of local taxes upon oil and gas property.

**Production Tax.** The tax rate for oil is 15 percent of gross value (12.25 percent for the first five years of commercial production from a lease or property coming into commercial production after June 30, 1981 and 15 percent thereafter) or \$0.60 per barrel of old oil (\$0.80 for other oil) adjusted by a factor related to the specific gravity of the oil. The tax rate for gas is 10 percent of gross value or \$0.064 per MCF (thousand cubic feet). The rates on both oil and gas are multiplied by an economic limit factor which is designed to reduce the tax rate as production volumes relative to production costs decrease.

**Oil and Gas Regulation and Conservation Tax.** A tax of \$0.00125 is imposed on the producers of oil for each barrel of oil removed or sold from each lease or property in the state.

**Royalty.** The State's royalty share is 12.5 percent, or one-eighth.

**Corporate Income Tax.** The corporate income tax is based upon a sliding scale--taxable income over \$90,000 is taxed at a rate of 9.4 percent. The taxable income base for oil and gas corporations is determined differently than other corporations.

### California

**Property Tax.** Property taxes are limited to one percent of the property's 1975-1976 valuation and do not increase more than two percent in annual valuation unless the property is sold. The rate is fixed locally to meet budget needs. The market value of producing oil and gas mineral property is determined by estimating the value of the volumes of proven reserves, which are those reserves that geological and engineering information indicate with reasonable certainty to be recoverable in the future.

**Oil and Gas Production Charges.** The production charge rate is determined annually by the Department of Conservation based on an estimate of the amount of funds that will be necessary to carry out the provision of the state's oil and gas conservation laws.

**Documentary Transfer Tax.** A tax is imposed by counties and cities on each deed, instrument or writing on lands or other realty which are within a county and are transferred to a purchaser--a tax on the value or purchase prices equal \$0.55 for each \$500.

**Royalty.** The royalty is 30 percent for oil and gas produced on state land.

**Corporate Income Tax.** The corporate income tax is a direct tax on net income (derived from sources within the state) of corporations not taxable under the Bank and Corporation Franchise Tax Act at the same rate as the franchise tax--9.6 percent of net income derived from business transacted in California.

## Louisiana

**Property Tax.** The Louisiana Constitution exempts the state's commercially most significant minerals, oil and gas, from any taxes except severance taxes.

**Production Tax.** Oil is generally taxed at the rate of 12.5 percent of its value at the time and place of severance--which is the greater of the gross receipts received from the first purchaser less trucking, barging, and pipeline fees or the posted field price. Gas is generally taxed at the rate of \$0.07 per MCF. Reduced rates are provided for less productive oil and gas wells.

**Royalty Gas Excise Tax.** A royalty gas excise tax is levied on each person producing gas in the state equal to the difference between the price received by the producer for the royalty owner's interest in the products and the price actually paid by the producer to the royalty owner.

**Royalty.** The royalty for oil and gas produced on state land varies between 20 and 25 percent.

**Corporate Income Tax.** The corporate income tax is base upon a sliding scale--net income in excess of \$200,000 is taxed at eight percent.

## Oklahoma

**Property Tax.** Most mineral property is exempt from ad valorem taxation.

**Production Tax.** Oil and gas is taxed at the rate of seven percent of the gross value of production, which means the gross proceeds realized from the first sale of such production including the cash value and all premiums otherwise given to or reserved for the producer and all interest owners of the production without any deduction for cost whatsoever.

**Oil and Gas Excise Tax.** In addition to the gross production tax, the state imposes excise taxes on oil and gas subject to the gross production tax at the rate of 0.85 percent of the gross value of the oil or gas produced.

**Conservation Excise Tax.** The state imposes a conservation excise tax on the severance of natural and casinghead gas. The amount of the tax is \$0.07 per MCF less seven percent of the gross value of each MCF.

**Royalty.** The royalty is 18.75 percent for oil and gas produced on state land.

**Corporate Income Tax.** The corporate income tax is five percent of the federal taxable income with adjustments.

## Texas

**Property Tax.** Minerals in place, and separate interest in such property are generally subject to ad valorem taxation at their fair market value. The taxation rate is fixed locally to meet budget needs.

**Production Tax.** The tax rate on oil is 4.6 percent of the market value or \$0.046 per barrel, whichever results in a greater amount of tax. The rate for gas is 7.5 percent of the market value of gas and liquid hydrocarbons other than condensate.

**Crude Petroleum Tax.** Texas imposes a tax of 3/16 of \$0.01 on each barrel of crude petroleum produce in the state.

**Royalty.** The minimum royalty for oil and gas produced off-shore of state land is 25 percent and the average on-shore royalty is 20 percent.

**Corporate Income Tax.** The state does not have a corporate income tax. A franchise tax of \$5.25 per \$1,000 stated capital, surplus and undivided profits allocated according to gross receipts from intrastate business is levied.

ATTACHMENT C

History of the TAPS Case Outline of  
the TAPS Settlement

1/28/88  
House Resources Committee  
Briefing

KEY EVENTS IN  
OIL PIPELINE RATEMAKING

<u>Date</u>	<u>Event</u>
1906	Hepburn Act passed; subjects oil pipelines to regulation under the Interstate Commerce Act.
1940-1944	Interstate Commerce Commission (ICC) employs the "valuation" methodology in three cases concerning the reasonableness of oil pipeline rates; these are the only pre-Williams cases that address the reasonableness question.
1941	<u>Atlantic Refining Consent Decree</u> entered, settling antitrust litigation. Decree limits pipeline company dividends to 7% OF ICC valuation.
Dec. 1971	Shippers protest Williams Bros. Pipe Line rates with the ICC.
June 1974	Administrative Law Judge (ALJ) upholds Williams rates.
Nov. 1975	ICC affirms ALJ decision in <u>Williams</u> . Case is appealed.
June 1977	Alaska (and others) protest TAPS rates with the ICC.
Oct. 1977	Jurisdiction over oil pipelines transferred from ICC to newly-created Federal Energy Regulatory Commission (FERC).
June 1978	On FERC's request, Court of Appeals remands ICC's <u>Williams</u> decision to FERC and orders FERC to "develop a viable precedent for oil pipeline ratemaking." (The Court of Appeals decision is referred to as <u>Farmers Union I.</u> )
Feb. 1980	ALJ issues decision on methodology issues in <u>TAPS</u> (Phase I); specific ratemaking issues are reserved for a subsequent hearing (Phase II).
July 1980	FERC hears oral argument concerning <u>TAPS</u> Phase I decision.
Feb. 1981	Alaska (and others) file a motion with FERC requesting a decision in <u>TAPS</u> (Phase I). Motion is denied.

<u>Date</u>	<u>Event</u>
June 1981	Shippers ask the Court of Appeals to order FERC to decide the <u>Williams</u> case (Phase I). FERC pledges to do so by Fall 1981 and the shippers' request is dismissed.
Feb. 1982- Dec. 1984	ALJ holds hearings in <u>TAPS</u> (Phase II).
March 1982	Alaska receives <u>TAPS</u> settlement offer from BP.
May 1982	Alaska Legislature informs Governor Hammond that it believes the State should reject the BP settlement offer and continue the Phase I litigation because of concerns over developmental effects on the North Slope and the relatively short length (10-years) of the proposed agreement.  Alaska files a motion with FERC requesting an expedited decision in <u>TAPS</u> (Phase I).
July 1982	FERC denies motion for expedited decision in <u>TAPS</u> saying its order in <u>Williams</u> will be accompanied by an order in <u>TAPS</u> .
August 1982	Seeing no FERC action in <u>Williams</u> , shippers file suit in District Court; Court orders FERC to decide Phase I in 60 days.
Nov. 1982	FERC issues <u>Williams</u> (Phase I) decision -- Opinion 154.  FERC remands <u>TAPS</u> (Phase I) to ALJ for hearings on whether the Opinion 154 methodology should be applied to TAPS.
Jan. 1984- Feb. 1984	ALJ holds TAPS (Phase I Remand) hearings.
March 1984	Court of Appeals remands <u>Williams</u> case to FERC, holding that the methodology adopted in Opinion 154 is inconsistent with the agency's mandate under the Interstate Commerce Act. (The Court of Appeals decision is referred to as <u>Farmers Union II</u> ).  Alaska (and others) file motion requesting FERC to decide Phase I of <u>TAPS</u> (on the ground that <u>Farmers Union II</u> has made the Phase I Remand moot). FERC takes no action.

<u>Date</u>	<u>Event</u>
Sept. 1984	Alaska engages in TAPS settlement negotiations with ARCO and BP; it also has contacts with Exxon and Sohio.
Nov. 1984	Alaska reaches handshake agreement with ARCO that settles Phase I and Phase II of <u>TAPS</u> .
Dec. 1984	U.S. Department of Justice approves Alaska-ARCO settlement agreement in <u>TAPS</u> .
Jan. 1985	<u>Williams</u> parties submit settlement of Phase II to FERC.  Alaska (and others) protest Kuparuk rates with FERC.
Feb. 1985	Alaska and ARCO sign the TAPS settlement agreement.
March 1985	FERC approves the <u>Williams</u> Phase II settlement.
April 1985	BP joins the TAPS settlement; the settlement is filed with FERC.
June 1985	Exxon, Mobil and Union join the TAPS settlement; the settlement is refiled with FERC.  FERC issues its decision in <u>Williams</u> (Phase I) -- Opinion 154-B.
July 1985	Phillips joins the TAPS settlement.
Aug. 1985	ALJs certify TAPS settlement to FERC.
Oct. 1985	FERC approves TAPS settlement as to signatory parties; remands the case to ALJs with respect to non-signatory parties.  Alaska (and others) protest Milne Point rates with FERC.
Dec. 1985	FERC issues its decision on rehearing in <u>Williams</u> -- Opinion 154-C. (No appeal is taken from Opinions 154-B and C.)
Feb. 1986	Sohio and Amerada Hess join TAPS settlement agreement; amendment to the agreement is filed with FERC.

<u>Date</u>	<u>Event</u>
April 1986	ALJs certify Sohio-Amerada Hess amendment to FERC.
June 1986	FERC approves Sohio-Amerada Hess amendment to TAPS settlement agreement.
Oct. 1986	FERC dismisses Milne Point investigation on motion of parties.
Nov. 1986	<u>Kuparuk</u> hearings held before FERC ALJ.
Sept. 1987	Alaska (and others) protest Endicott rates with FERC.
Oct. 1987	Court of Appeals rejects Arctic Slope Regional Corporation (ASRC) challenge and affirms FERC approval of the TAPS settlement.
Jan. 1988	Court of Appeals denies ASRC request for rehearing in the <u>TAPS</u> case.

1/10/85

## OUTLINE OF TAPS SETTLEMENT

## HAVE REACHED AN AGREEMENT WITH ARCO

Final document in next 3-4 weeks  
 Not all companies on board  
 Numbers are if all join up

## TAPS TARIFF DIRECTLY AFFECTS ANS WELLHEAD PRICE

Severance tax and royalty on wellhead  
 No market at wellhead  
 Decrease in tariff directly increases wellhead  
 We get 25-30% of wellhead increase from state lands

## REVENUE CONSEQUENCES TO STATE - CHART I AND GRAPH

\$2.9 billion more than currently forecast (\$2.14 billion in  
 1985\$)

Annual amounts gained (millions)

	<u>Calendar</u>	<u>Fiscal</u>
1985	\$233.0	
1986	\$153.6	\$309.8
1987	\$200.4	\$177.0
1988	\$232.3	\$216.4
1989	\$256.2	\$244.3
1990	\$261.7	\$259.0
1991	\$235.7	\$248.7

Effective date of settlement would be January 1, 1986  
 Tariffs would drop in 1985 by 72 cents, and continue to drop  
 in later years, both in real and nominal terms CHARTS  
 II AND III AND GRAPHS

## PRINCIPLES OF SETTLEMENT

- 1) State wants to defer revenues to 1990's  
 A constant dollar in the 1990's is worth the same to  
 the state as that same dollar today
- 2) Encourage development of ANS reserves in 1990's  
 Prudhoe and Kuparuk already on stream with present  
 tariffs  
 Low 1990s tariffs will encourage places like  
 Beaufort, native lands and other fields where  
 production might not otherwise be economic  
 Certainty now aids economic planning for 90's -  
 litigation makes planning uncertain

# MEMORANDUM

# State of Alaska

TO: Tax Policy Committee


DATE: September 16, 1986

FILE NO.:

THRU:

TELEPHONE NO.: 465-2302

SUBJECT: Severance Tax (AS 43.55)

FROM:   
Richard D. Monkman  
Deputy Commissioner, Taxation

Attached is a memorandum which discusses some policy considerations behind the severance tax, written several years ago by former Assistant Attorney General Jon K. Tillinghast. Of particular interest is the memorandum's historical perspective on resource development in Alaska.

RDH:mkw

Attachment

cc: Royce Weller